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No. .....

In The

Supreme Court of the United States

October Term, 1984

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FEDERAL DEPOSIT INSURANCE CORPORATION,
in its corporate capacity,

Plaintiff-Appellee,

vs.

RICHARD M. WOOD,

Defendant-Appellant.

—o—

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

—o—

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QUESTIONS PRESENTED FOR REVIEW

1. Does the judicial power of the United States, contained in Article III of the Constitution, extend to a suit begun in a state court by a state bank and involving interpretation of a simple promissory note, where the makers and guarantor of which were Michigan citizens, and the lending bank was organized under Michigan law, upon the voluntary acquisition of the note by the FDIC in a "purchase and assumption" transaction involving the state bank after its failure, so as to invest the federal courts with subject matter jurisdiction of the pending suit?

2. If the federal courts have subject matter jurisdiction in the circumstances set forth in Question 1, does the common law of the United States prevent the guarantor (or the maker) of the note from raising and prevailing against the FDIC upon the defense of usury appearing on the face of the note?

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TO THE HONORABLE CHIEF JUSTICE OF THE UNITED STATES AND THE JUDGES OF THE SUPREME COURT OF THE UNITED STATES:

RICHARD M. WOOD (WOOD), Petitioner herein, petitions this Honorable Court for a writ of certiorari to review the order of the United States Court of Appeals for the Sixth Circuit affirming on appeal the order and judgment of the District Court granting judgment notwithstanding the verdict to Plaintiff-Appellee, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC), and respectfully shows:

REFERENCE TO OFFICIAL AND UNOFFICIAL REPORTS OF OPINIONS OF LOWER COURTS

1. The opinion of the District Court is reported as *FDIC v Stone*, at 578 F. Supp. 144 (E.D. Mich. 1983).

2. The opinion of the Court of Appeals for the Sixth Circuit is recommended for full text publication under the rules of the Sixth Circuit, but has not yet been published.

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JURISDICTION OF THIS COURT

1. The judgment sought to be reviewed was decided and filed March 26, 1985.

2. No petition for rehearing was filed with the Court of Appeals.

3. It is believed that 28 USCA 1254(1) confers jurisdiction on this Court to review the action of the United States Court of Appeals for the Sixth Circuit.

———o———

CONCISE STATEMENT OF THE CASE

This is an action on a $12,000 note which had been renewed several times. The makers of the note were Peter R. Stone and Carole K. Barnett, his wife at the times the note was signed and renewed. The Stones have been divorced in the interim and the former Mrs. Stone had assumed her maiden surname of Barnett. Defendant-

Appellant Richard M. Wood (WOOD) was claimed to be liable on his guaranty agreement for unpaid principal and interest. Stone, Barnett and WOOD, at all pertinent times, were citizens and residents of the State of Michigan.

Suit was commenced on December 9, 1981, by Community Bank of Washtenaw, a Michigan banking corporation, against Peter R. Stone and Carole K. Barnett, formerly, Carole Stone, in the Washtenaw (Michigan) County Circuit Court. It was alleged that the promissory note in question was due and payable on September 22, 1980, and that Defendants had paid only $100 against such amount, and the bank requested a judgment for the balance of the principal, plus interest.

Subsequently, Community Bank failed and the Federal Deposit Insurance Corporation (FDIC) was appointed receiver for it on May 15, 1982. Also on May 15, 1982, "the FDIC in its capacity as receiver of the bank sold to the FDIC in its corporate capacity, certain assets of the bank, one of which is the defaulted Promissory Note which is the subject matter of this case." (paragraphs 16 and 17 of Amended Complaint).

On November 6, 1982, the FDIC was substituted for Community Bank as Plaintiff in the State Circuit Court action, being the assignee of the note executed by the Stones. On December 3, 1982, the FDIC filed a petition to remove the action to the United States District Court. On January 14, 1983, an order was entered in the District Court permitting Plaintiff FDIC to add additional parties. On or about January 26, 1983, a First Amended Complaint was filed in which WOOD was added as a Defendant and was alleged to be liable as guarantor, under a separate instrument, of the note executed by the Stones.

WOOD filed Answer, and filed a Crossclaim against each of the Stones, who in turn each filed Crossclaims against WOOD. All Defendants asserted the defense of usury. Under Michigan law, all payments made upon an usurious note are applied against principal, so that, upon the determination by the jury and the Court that the note in question was usurious, all interest payments made on the note and/or any previous renewals of the original note were applied against the $12,000 original principal balance, along with the amount specifically paid on principal.

Upon the trial, the jury returned a special verdict in which it determined, inter alia, that the note being sued upon was usurious; all Defendants were liable to the FDIC on the note and guaranty, jointly and severally; and, WOOD was liable to indemnify the Stones based upon the claims raised in their respective Counterclaims. A judgment was entered in favor of the FDIC in the amount of $5,751.76 plus judgment interest to date of payment.

All Defendants filed motions seeking reimbursement for attorney fees and costs (not punitive costs, as stated in the Sixth Circuit Opinion) permitted the successful party asserting the defense of usury, under Michigan law, specifically citing MCLA 438.32. The FDIC opposed all such motions and brought a Motion for Judgment Notwithstanding the Verdict, which in turn was opposed by all Defendants. The FDIC's Motion for Judgment N.O.V. was granted by the Court by order dated December 22, 1983, and a second judgment in the amount of $14,890.25 was entered. Defendants' motions for costs and attorney fees were denied.

WOOD appealed from the District Court's Order Granting Judgment N.O.V. The FDIC did not move for a new trial. Neither Stone nor Barnett has joined in the appeal. The FDIC did not file a cross-appeal.

Appellant Richard M. Wood does not in this proceeding seek to overturn the jury verdict and the $5,751.76 judgment entered pursuant thereto.

The only facts relevant to this appeal are that the District Judge granted the FDIC's Motion for Judgment N.O.V. and denied Appellant's Motion for Attorney Fees and Costs allowable under Michigan law because the District Judge was of the opinion that, as a matter of law, the FDIC "should" occupy a "status equivalent to that of a holder in due course and have all of the rights that are available to a holder in due course when acting in its corporate capacity" and that, therefore, the FDIC is exempt from operation of the Michigan usury statute where it acquires usurious negotiable paper of a failed bank, while acting in the FDIC's corporate capacity.

In making this ruling, the District Judge did not overturn, or attempt to overturn, the special finding made by the jury that the note in question was not for a business purpose and, therefore, is usurious under Michigan law. Thus, the facts of the case, for all practical purposes, are contained in the District Judge's Memorandum Opinion and Order dated December 22, 1983, and the Judgment Notwithstanding the Verdict entered by the Court on January 23, 1984.

The United States Court of Appeals for the Sixth Circuit, in its opinion decided and filed March 26, 1985, affirmed the Judgment N.O.V. entered by the District

Court. WOOD seeks the issuance of a writ of certiorari by this Court to review the judgment of the Court of Appeals for the Sixth Circuit.

The essence of WOOD's appeal to this Court lies in these paradoxes. First, both the District Court and the Sixth Circuit Court of Appeals concede that the original judgment of $5,751.76 entered by the court correctly reflected WOOD's liability under state law, but neither federal court would enforce the state law result. Second, both the District Court and the Sixth Circuit Court of Appeals conceded that each of the four conditions set forth in 12 USC § 1823(e), which is a codification of this Court's holding in *D'Oench, Duhme & Co. v. FDIC,* 315 U.S. 447 (1942) have been met, but neither court would apply the plain provisions of both the federal statute and this Court's *D'Oench* decision.

All 50 states have adopted the Uniform Commercial Code (UCC). The FDIC cannot qualify as a holder in due course under the UCC in these types of transactions because it purchases the assets of failed banks at judicial sale and in bulk quantities. This Court's holding in *D'Oench,* supra, and the subsequent enactment of § 1823(e) protect the FDIC against oral, secret or nondisclosed defenses not evident from the failed bank's records.

Since the FDIC is already protected against oral, secret or nondisclosed defenses under U.S. statute law, the effect of the decision in this case is to prevent the assertion of defenses which appear on the face of the instrument or which can be verified through a review of the bank's records.

Although both lower courts concluded that federal common law is applicable to decision, neither court explained why this should be so in interpreting a contract drawn in the State of Michigan, among citizens of the State of Michigan, and obviously controlled by the law of the State of Michigan. Under Michigan law, a note usurious on its face bars the usurious lender or his assigns from the collection of any interest, official fees, collection charge, attorney fees, or court costs, and the borrower can recover attorney fees and court costs, Mich. Comp. Laws Ann. § 438.32, so that the holder of the note is always entitled to recover the principal amount loaned but is never entitled to recover interest, attorney fees, court costs, etc. This bar arises at the moment the contract comes into existence and applies to every usurious lender and every assign of a usurious lender.

There can be no such thing as a holder in due course where the usurious nature of the note appears on the face of the note. The bar of the statute from the collection of any usurious interest, etc., applies however "innocent" the action of the holder of the note, whether that holder of the note is the original lender, the assign from the lender, or any subsequent assignee.

Both lower courts have held that the voluntary acquisition by the FDIC of the interest of the lender, who or which on the face of the subject instrument has violated the laws of the State of Michigan, has the effect of creating liability for interest, costs, and attorney fees which neither the makers nor the guarantor ever had under the laws of the State of Michigan. The note usurious on its face was never fully enforceable from the time of the inception of the note, regardless of the character, nature, or status of the holder of that note.

Both of the lower courts viewed the case as being dependent upon the activities of the FDIC, and rationalized to a decision, not simply that the FDIC was or should be deemed a holder in due course, but rather that the FDIC has, under federal common law, litigation superstatus which in effect exempts it from any usury defense. Since both lower courts concede that the FDIC was not and could not be a holder in due course under state law, the issue which appears to actually have been litigated and decided is whether the voluntary acquisition of an usurious paper by the FDIC in a voluntary purchase and assumption transaction authorized under federal statute has, or can have, the effect of creating liability for the payment of interest under a state note contract where neither the makers nor the guarantor had any such liability prior to such voluntary acquisition by the FDIC.

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BASIS FOR FEDERAL JURISDICTION IN THE COURT OF FIRST INSTANCE

Suit was instituted in Michigan's Washtenaw County Circuit Court. No claim of federal jurisdiction was made in the original Complaint in that court. Neither lower federal court has made any finding that there was any basis for federal jurisdiction in the court of first instance.

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ARGUMENT

Petitioner urges that this Court allow the issuance of a writ of certiorari in this matter for the following reasons:

1. The contract [illegible] therefore suit upon the contract, did not and ordinarily does not arise under the laws of the United States, because the FDIC was not an original party to the note or guaranty, and therefore, there is no subject matter jurisdiction in the Federal Courts. Constitution, Art. III, Sec. 2.

2. Provisions of the UCC, adopted by the legislatures of all 50 states, and the provisions of 12 USC § 1823(e) apply and are in perfect harmony. The FDIC, in dealing in commercial paper under the UCC, is treated under the laws of every state in the union exactly as every other individual or dealer is treated. Under § 1823(e), the FDIC is accorded absolute protection against any and all claims or defenses not appearing in the documents acquired by the FDIC.

3. There is neither the need nor the occasion for the Federal Courts to create new law for the specific benefit of one federal agency.

4. The rule adopted by the Court of Appeals does not simply permit the FDIC the opportunity to become a holder in due course—it creates an irrebuttable presumption that the agency is in fact a holder in due course.

1.

The Federal Courts Have No Subject Matter Jurisdiction

The Court of Appeals stated the issue to be "whether the FDIC can recover the full amount of interest payable on the note when the jury found it to be usurious under state law."

The Constitution, Sec. 2. [1], Art. III, provides in pertinent part:

> "The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority; . . .".

The simple note in question was made among Michigan citizens; was guaranteed by a Michigan citizen; was made payable in the State of Michigan; was physically executed in the State of Michigan; and, derives its vitality from the laws of the State of Michigan. No federal law affected the creation of this instrument. No Michigan law provides that interest under this note is payable to any person under any circumstances. Michigan law expressly bars the collection of any interest, official fees, collection charge, attorney fees, or court costs.

Mich. Comp. Laws Ann. Section 438.32 provides:

> "Any seller or lender or his assigns who enters into any contract or agreement which does not comply with the provisions of this act or charges interest in excess of that allowed by this act is barred from the recovery of any interest, any official fees, delinquency or collection charge, attorney fees or court costs and the borrower or buyer shall be entitled to recover his attorney fees and court costs from the seller, lender or assigns."

The federal judiciary simply has no subject matter jurisdiction in this case. From its inception, the note, being usurious on its face, bore no interest. There was never any "interest payable on the note" because the state law which governed the creation of the note forbade and barred the collection of any interest, etc. on the note.

The statutory declaration contained in 12 USC § 1819, relied upon by the lower courts, recites that:

> "All suits of a civil nature at common law or in equity to which the Corporation shall be party shall be deemed to arise under the laws of the United States, and the United States district courts shall have original jurisdiction thereof, without regard to the amount in controversy; . . . except that any such suit to which the Corporation is a party in its capacity as receiver of a State bank and which involves only the rights or obligations of depositors, creditors, stockholders, and such State bank under State law shall not be deemed to arise under the laws of the United States."

WOOD does not question the right of the FDIC to remove the suit to the District Court for determination. But what is at issue in this case is the value of the asset in the hands of the receiver of this State bank. The District Court, based upon the findings of special facts by the jury, determined the value of that asset to be $5,751.76. The Court of Appeals did not dispute this determination. It stated:

> "If we considered the FDIC to be a holder other than in due course and applied state law, makers of notes would get an unjustified windfall. If the maker has a personal claim against the defendant bank, he would effectively have an absolute priority on that claim. We think a maker with a claim against the defunct bank should have to stand in line with the other unsecured creditors proceeding against the FDIC in its capacity as receiver."

The FDIC in its Complaint specifically alleged that it was the assignee of the receiver of the State bank. The defenses raised by Defendants, including WOOD, appear on the face of the note.

The sole event claimed to justify a judgment in the sum of $14,890.25, rather than $5,751.76, is the fact that the FDIC *voluntarily* acquired the note in its corporate capacity from itself as receiver of the failed State bank.

While both lower courts claimed to be relying upon the decision of this Court in *D'Oench, Duhme & Co. v. FDIC,* 315 U.S. 447 (1942), that case was decided on the basis that the court found that the maker of the note, *by its conduct,* was estopped to plead defenses not apearing as part of the note at issue. The opinion in *D'Oench,* p 461, recites:

> "If the secret agreement were allowed as a defense in this case the maker of the note would be enabled to defeat the purpose of the statute by taking advantage of an undisclosed and fraudulent arrangement which the statute condemns and which the maker of the note made possible."

There is no claim or suggestion, by either lower court, that either WOOD or the makers of the notes conducted themselves in any manner so as to give rise to a defense of estoppel. The usury defense can prevail only when it is shown that the *lender* violated public policy. If the FDIC, either in its insuring or bank supervisory capacity, sanctioned such unlawful activity on the part of the insured or regulated bank, then it too violated Michigan's public policy, which actions should not be rewarded when a bank fails.

WOOD is aware of no federal or state statute or court decision which prohibits the maker or guarantor of a note from asserting defenses appearing on the face of the note in question. The rules adopted by the lower courts do not constitute applications of federal common

law; they amount to revisions of state law by the federal judiciary. Additionally, they go far beyond the holder in due course concept, itself a variation of the principal of estoppel, by holding that this one federal agency is entitled to irrebuttable holder in due course status, even though there can be no such thing as a holder in due course of a note usurious on its face.

2.

State And Federal Statutory Laws Apply And Require A Different Result From That Reached By The Court Of Appeals

a.

The Uniform Commercial Code (UCC) Has Been Adopted By The Legislatures Of All Fifty States And Both Lower Courts Concede That, Under The UCC, The FDIC Could Not Collect Interest On The Note

Both lower courts concede that the FDIC is not a holder in due course under the UCC. The Legislatures of all fifty states have adopted the UCC. Mich. Comp. Laws Ann. Sec. 440.3302, Section 3302 of the UCC, provides in pertinent part:

> "(1) A holder in due course is a holder who takes the instrument
>
> (a) for value; and
>
> (b) in good faith; and
>
> (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.
>
> . . .
>
> (3) A holder does not become a holder in due course of an instrument:

(a) by purchase of it at judicial sale or by taking it under legal process; or

. . .

(c) by purchasing it as part of a bulk transaction not in regular course of business of the transferor.

. . ."

Under subsection (3), the FDIC can never become a holder in due course in a purchase and assumption agreement, either because it purchases at a judicial sale or because it purchases as part of a bulk transaction not in regular course of business of the transferor. Both lower courts appeared to be initially troubled with the fact that the FDIC can never be a holder in due course under the provisions of Section 3302(3). Something about the provisions of subsection (3) were apparently considered to be unfair by the lower courts. The District Judge based his entire ruling upon the proposition that even though the FDIC obviously did not qualify as a holder in due course, the District Judge was of the personal opinion that the FDIC "should" be accorded the status of a holder in due course.

The Court of Appeals suggests that the UCC requirements for qualification as a holder in due course, which prevent the FDIC from being such a holder, are "without purpose.", and that the defense of usury, even where it appears on the face of the instrument, is a "personal" defense, rather than a "real" defense.

The Court of Appeals claims that a "real" defense renders a note "invalid and unenforceable by anyone.", while a "personal" defense, including usury, is not truly

a defense "against the note itself," but rather is a defense or claim stemming from the underlying transaction. Of course, in this last statement or assumption, the Court of Appeals is in obvious error. Under Section 3302(1)(c), a holder of a note usurious on its face obviously takes the instrument, when he acquires it, with notice of the defense of usury. Where the instrument is usurious on its face, the usury defense may be asserted by the maker or guarantor whether or not the holder otherwise qualifies as a holder in due course and regardless of the circumstances under which the holder acquired the instrument.

In addition to the fact that the FDIC acquired the note at a judicial sale and the fact that it purchased the note as part of a bulk transaction not in the regular course of business of the transferor, the FDIC in this case could not have been a holder in due course because:

(1) The note was 18 months overdue when it was acquired by the FDIC.

(2) The makers had not paid it when due and the original lender had instituted suit on the note approximately six months before the FDIC acquired it.

(3) As noted, the note was usurious on its face.

It should perhaps be brought to the Court's attention that it was the FDIC, and not WOOD, which injected into the case the question of whether the loan was for a business purpose or to a business entity. Notwithstanding the fact that the makers of this note used the proceeds as a down payment on the purchase of their personal residence, the FDIC asserted that the loan was a business loan and was therefore not usurious. The jury, in its special findings of fact, rejected this contention of the

FDIC. The Court of Appeals then claimed that WOOD argued that "the lack of a statement in the bank's files should have warned the FDIC of the usury defense." Pointing out the failure of the FDIC to establish its allegations should not be transposed into a claim by WOOD that there must be both a usurious rate and the lack of such a statement in order to establish the usury defense.

b.

12 USC § 1823(e) Specifically Contemplates The Assertion Of The Usury Defense Where The Note Is Usurious On Its Face

Both lower courts held that 12 USC § 1823(e) did not apply in this case. Both lower courts conceded that § 1823(e) is in effect the codification of this Court's holding in *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942). Both lower courts conceded that § 1823(e) would not prevent the assertion of a usury defense. Such section provides:

"(e) Agreements against interests of Corporation

No agreement which tends to diminish or defeat the right, title or interest of the Corporation in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.

Of course, subsections (1), (2), (3), and (4) of § 1823(e) were all literally complied with in this case.

The agreements being sued upon were the note, and the guaranty agreement executed by WOOD. The only issues were the amounts owed under these agreements, if any. No Defendant claimed or introduced any other agreement, either written or oral, which they claimed tended "to diminish or defeat the right, title or interest of the corporation in any asset acquired by it under this section, . . .". While § 1823(e) is stated in the negative, it must be positively read as permitting the assertion of any defense which diminishes or defeats the right, title or interest of the FDIC where such defense appears in the document or agreement upon which the FDIC asserts its cause of action.

The Court of Appeals, in refusing to apply § 1823(e), asserts that "There is authority that Congress intended by means of section 1823(e) to clothe the FDIC with the protections afforded a holder in due course." and the Panel's personal belief was that "although section 1823 manifests the congressional intent to protect the FDIC, it does not of itself authorize holder-in-due-course status."

WOOD submits that it would have been impossible for this Court to have rendered its opinion in *D'Oench* or for the Congress to have enacted § 1823 without at the same time considering whether the FDIC should be accorded holder in due course status. Neither this Court nor the Congress expressed any concern that agreements acquired by the FDIC would be enforced under the plain provisions of the agreement or that such agreements would be enforced according to state law.

As to this point, see *FDIC v. Hatmaker,* 756 F.2d 34 (1985), written by the same Judge Martin. The Sixth Circuit in *Hatmaker* held that § 1823(e) barred the maker from asserting an oral agreement in defense to the FDIC's suit. It stated, p 37:

"We believe that this result comports with the purpose of section 1823. The purpose is to protect the FDIC from *hidden agreements* that would defeat its interest in what is otherwise a facially valid note. Such hidden agreements would prevent the FDIC from accurately valuing assets and from making informed decisions on how best to handle a bank's insolvency. *The concern is thus with agreements that are not made part of the note.*" (Emphasis supplied).

There is simply no basis for the assumption of the Court of Appeals that Congress misspoke itself and, therefore, the federal judiciary must step in to prevent frustration of the "objectives of the federal program".

3.

There Is Neither The Need Nor The Occasion For The Federal Courts To Create New Law For The Specific Benefit Of One Federal Agency

WOOD suggests that the Court of Appeals acted precipitately in purporting to discover or adopt new principles of federal common law, in a case where the need for such action is something less than obvious. To reject the collective wisdom of the legislatures of all fifty states and to assume as a basis for its decision that the Congress intended, but could not effectuate, holder in due course status for the FDIC, in a case involving attempted collection on a simple note, evidences a willingness by the judiciary to undertake a task for which it is ill-prepared. It is a variation of judicial legislation. There are any number of factual situations which require for their resolution the establishment of rules in the first instance by the judiciary. This is not one of those cases.

Appellant offers the following observations:

(1) The FDIC is more than fifty years old. Yet, this is the first case decided by a Federal Circuit Court of Appeals in which the state usury

laws were held inapplicable simply because the FDIC acquired the asset. In that fifty year span, there is no claim that the FDIC has lost so much as $100 by applying state law to suits on notes.

(2) Appellant, himself a lawyer, and this writer can thus be excused for being overwhelmed by the statement of the Court of Appeals that, were it to rule in WOOD's favor, such ruling would be made "at potentially enormous costs to the banking system as a whole."

(3) WOOD feels at times like the Mouse That Roared, but, upon reflection, we have concluded that a nation which can pledge more than four billion dollars of the taxpayer's money to shore up Continental Illinois Bank, even when not obligated legally to do so, can survive an adverse decision on a $9,000 or $10,000 claim, if WOOD prevails in this case.

(4) The Court should understand that no trial transcript was filed in connection with this appeal. Everything that the Court of Appeals wrote about the good faith of the FDIC; about refunds when the FDIC collections exceed the amount the FDIC paid in the purchase and assumption transaction; about the FDIC's purpose; about a purchase and assumption transaction and the alternative of liquidating the bank's assets and paying the depositors their insurance; about the need for speed in the FDIC transaction, even though it is purchasing assets from itself as receiver of a failed bank; about the potentially enormous costs to the banking system as a whole; about the adverse consequences to allowing makers to assert personal defenses against the corporate FDIC; about whether creating the FDIC as

a holder in due course would disrupt commercial relationships predicated on state law; and, about whether the FDIC had actual knowledge at the time it acquired the asset, were all taken from other materials, other cases and sources never presented to or considered by the jury or the District Judge. None of the "facts" relied upon by the Court of Appeals are claimed to have been taken from the special verdict returned by the jury.

(5) The Court of Appeals purported to rely on and apply this Court's opinion in *United States v. Kimbell Foods,* 440 U.S. 715 (1979). This Court, in *Kimbell,* held that, where a national rule is unnecessary to effectuate federal interests, state law should be incorporated as the federal rule of decision. It should be pointed out that there already is in effect a "nationally uniform body of law", namely the UCC and 12 USC § 1823(e). This Court did not hold in *Kimbell* that the federal courts are free to change a "nationally uniform body of law" simply because they disagreed with that nationally uniform body of law.

(6) The next *Kimbell* test supposedly employed by the Court of Appeals was whether application of Michigan law, which has adopted the UCC, "would frustrate specific objectives of the federal program", Again, as noted, the only possible loss to the FDIC in this case would be some $10,000. There is no claim that the specific objectives of the FDIC program have ever been or would be frustrated in any other way.

(7) The last *Kimbell* test employed by the Court of Appeals was whether "treating the FDIC as a

holder in due course would disrupt commercial relationships predicated on state law." There was no testimony or even hint of testimony on this point upon the trial. The Court stated:

> "From the maker's view, there is no difference between his bank failing and the note going to the corporate FDIC, and his bank failing and selling the note to a holder in due course."

As previously noted, this assumption by the Court of Appeals is patently erroneous. A maker could always raise the usury defense where the note is usurious on its face against any other person or entity. A purchaser of a note usurious on its face cannot by definition be a holder in due course because he is charged with notice of the defect appearing on the face of the instrument.

(8) The Court of Appeals partially justifies its opinion with these two statements relating to *receivership:*

> "When an insured bank goes into receivership, the FDIC in most cases will in fact be a good-faith holder of its notes. If the FDIC had no knowledge, *prior to receivership,* of defenses to the notes, and if it otherwise acted in good faith, it cannot be said that the FDIC is not innocent."
>
> "We think a maker with a claim against the defunct bank should have to stand in line with the other unsecured creditors proceeding against the FDIC *in its capacity as receiver."* (Emphasis supplied).

The Court of Appeals seems confused as to what it is ruling on in this case. Even the FDIC concedes in this case that matters involving receivership, or the FDIC acting in the capacity of receiver, are governed

strictly by provisions of state law. No state declares a receiver a holder in due course. Apparently, all states would permit offsets of note liability against any liability of the bank to the maker of the note.

(9) The Court of Appeals opined that what it perceives to be relief to makers of notes "should be authorized only by Congress.", while it feels that federal courts have the power to "give the FDIC preferential treatment in other contracts."

It should be obvious that the question of special privilege for one federal agency is a matter to be established by the Congress, after consideration of all of the effects of any such legislation.

4.

The Ruling Of The Court Of Appeals Constitutes An Irrebuttable Presumption That The FDIC Is A Holder In Due Course And Creates A Property Right In The FDIC Not Enjoyed By Anyone Else

The Court of Appeals concludes its opinion in this manner:

> "For these reasons, we hold that when the FDIC in its corporate capacity, as part of a purchase and assumption transaction, acquires a note in good faith, for value, and without actual knowledge of any defense against the note, it takes the note free of all defenses that would not prevail against a holder in due course. This rule was implicit in this Circuit's holding in *Gilman v. FDIC*, 660 F.2d 688, 695 (6th Cir. 1981), . . .".

Even though *Gilman* did not involve a usury question, the Court of Appeals stated that under *Gilman*, the

> "FDIC is under no duty, in either of its capacities, to examine the assets of a failed bank before it agrees

> to execute a purchase and assumption transaction. 660 F.2d at 694. The FDIC cannot, therefore, be charged with knowledge of a defense merely because that information could be found in the bank's files. Furthermore, actual knowledge must be shown as of the date the FDIC entered into the purchase and assumption agreement....
>
> In this case, plaintiff's assertion that the FDIC had knowledge of the defense was based only on the fact that an examination of the bank records should have put the FDIC on notice. That allegation is not sufficient to overcome the presumption that the FDIC had no knowledge of any defenses against it."

The holding of the Court of Appeals nominally retains the requirements that the FDIC, to become a holder in due course, must take (a) for value, and (b) in good faith. As to the FDIC only, it eliminates the prohibition against becoming a holder in due course where the instrument is purchased at judicial sale or under legal process, and/or where it is purchased as part of a bulk transaction not in regular course of the business of the transferor. As to the FDIC only, the Court of Appeals would eliminate the requirement that the holder take the instrument before it is overdue (in this case, the note was 18 months overdue) and where the note had been dishonored (in this case suit had been pending on the note for six months prior to its acquisition by the FDIC).

Finally, the Court of Appeals would provide, as to the FDIC only, that the requirement that the holder acquire the instrument "without notice of any defense against or claim to it on the part of any person," be changed, to provide "without actual knowledge of any defense against the note, . . .". After replacing the UCC requirement that the holder's acquisition be "without notice that it is overdue or has been dishonored or of any

defense against or claim to it on the part of any person", with the requirement that the acquistion be "without actual knowledge of any defense against the note," the Court of Appeals literally precludes a maker or guarantor of the note from asserting the usury defense by holding that "information which could be found in the bank's files." does not constitute "actual knowledge" and that "actual knowledge" must be shown as of the date the FDIC entered in the purchase and assumption agreement.

In *FDIC v. Merchants National Bank,* 725 F.2d 634, 637 (1984), cited by the Court, the Eleventh Circuit upheld the district court's action in excluding as irrelevant "Any evidence *not found in the records of the bank* and not meeting the statute's strict requirements." Obviously, the FDIC cannot include in evidence or be bound only by those bank records which it deems favorable to it.

The reasoning of the Court of Appeals in this matter is faulty. In this case, and in the overwhelming majority of these bank failures, the FDIC was and is named as the receiver and subsequently enters into a purchase and assumption transaction with itself in its corporate capacity. It is simply not realistic to create an irrebuttable presumption of either lack of notice or lack of actual knowledge on the part of the FDIC in a transaction conducted by it in secret and conducted with itself in its two statutory capacities, where the defense asserted appears in the instrument under which the FDIC seeks relief.

The Court of Appeals has made a determination that the FDIC, in its capacity as receiver under state law of the assets of the failed bank, did not have actual knowledge of any defense against the note in question even though it was 18 months overdue; the bank had started suit on the note more than six months previous to acquisi-

tion by the FDIC; and the note on its face was usurious under Michigan law. The Court of Appeals would then have us believe that the FDIC, in its corporate capacity, and as purchaser of the assets from the receiver (itself), did not have actual knowledge of any of these defenses on the date it entered into the purchase and assumption agreement with itself, even though the Court of Appeals acknowledged that "the FDIC transferred the remaining, lower-quality assets, including this note, to itself in its corporate capacity." The FDIC, in its briefs, refers to these "lower-quality assets" as "nonperforming loans", part of the "classified loan portfolio (bad debts) of the failed bank."

The FDIC, in its capacity as receiver, could not marshal, evaluate, classify or sell the assets without somehow examining the assets or the records of the bank. The receiver must determine how much is owing on each note.

The FDIC, in its corporate capacity, could not make the decision required by statute that the purchase and assumption was more favorable to it than the alternative of liquidating the assets of the insured bank, without examining the assets or records of the failed bank. The FDIC, in its capacity as receiver, and the FDIC, in its corporate capacity, could not enter into any meaningful purchase and assumption agreement without listing the assets; classifying the assets; and settling upon the terms of the sale.

In *Gunter v. Hutcheson*, 674 F.2d 862, 870 (1982), also cited by the Court, the Eleventh Circuit, banning a claim of fraud, stated:

> "Under [§ 1823(e)], the FDIC may enter a purchase and assumption transaction only 'whenever in the judgment of the Board of Directors such action will

reduce the risk or avert a threatened loss to the Corporation. . .' To make this statutory judgment, the FDIC must have some method to evaluate its potential liability in a purchase and assumption versus its potential liability from a liquidation. *Because of the time constraints involved, the only method of evaluating potential loss open to the FDIC is relying on the books and records of the failed bank to estimate what assets would be returned by a purchasing bank and to estimate which of those assets* ultimately would be collectible. The Corporation can then compare its estimated loss from a purchase and assumption against its estimated loss from a liquidation and make the statutory judgment required under § 1823(e)." (Emphasis supplied).

Lastly, the arguments relied upon by the Court of Appeals that speed is of the essence to a successful purchase and assumption transaction might have force as to those assets sold, overnight, to a successor bank. Neither the successor bank nor the FDIC had any difficulty in this case, or in any of the cited cases, in determining which assets were of "lower-quality". The speed arguments have no force as to assets which are to be acquired and collected on by the FDIC in its corporate capacity. There is no reason why, as to those assets, the agreement must be made overnight and in secret or why any such agreement could not be modified to exactly reflect the true value of the assets after examination by the FDIC staff. The Court of Appeals admits that any surplus recovered on these lower-quality assets is returned to the receiver.

Since the FDIC is required by statute and by the terms of its insuring agreements to indemnify covered depositors against any loss resulting from an insured bank's failure, it cannot be argued that the FDIC is a "good-faith" holder of notes acquired in a purchase and

assumption transaction, without "actual knowledge". The FDIC enters into this type of transaction only when it is to its benefit, as acknowledged by the Court of Appeals.

Reduced to its bare essentials, the holding of the Court of Appeals is simply to the effect that if the FDIC acquires a note for value, it must by that action, and as a matter of law, be deemed to be a holder in due course, even though there can be no holder in due course of an instrument usurious on its face.

The effect of such holding is to create a property right in the FDIC, and *only the FDIC,* contrary to the law of the state. Every other person or entity who or which might hold this note is barred from collection of interest on it because it is usurious on its face.

The federal judiciary has no power to amend duly enacted state statutes, either to bring the FDIC within the definition of a holder in due course or to create a liability for the payment of interest on a note where no such liability exists under state law. It can, of course, declare such state enacted statute unconstitutional and thus void and unenforceable. WOOD submits that if the usury provisions contained in Mich. Comp. Law Ann. Section 438.32 are somehow unconstitutional, then the note in question is invalid also. But there has never been a claim raised by the FDIC in this case that the note in question was at any time prior to its acquisition by the FDIC invalid. Indeed, the theory of the Community Bank and the FDIC is that both the note and the guaranty agreement are valid instruments giving rise to Plaintiff's cause of action. Otherwise, there could be no lawsuit.

The rule which the Sixth Circuit Court of Appeals purported to adopt as a rule of federal common law can-

not withstand analysis. The validity of the usury provisions contained in the Michigan law cannot depend upon the fortuitous events of whether or not the FDIC elects to acquire the asset and/or whether the failed bank's condition is such as to permit of such an election. In any event such election can only be made by the determination that the acquisition is favorable to the FDIC, which in turn can only be based upon "actual knowledge" or notice of defenses appearing on the face of the instrument.

The only possible legitimate federal question which could have been posed under the facts of this case is whether a note created under state law, and otherwise valid, is somehow made invalid by the fact that the lender is an insured under a contract with the FDIC. The FDIC cannot prevail in an action of this type whether the answer to that question is either "yes" or "no".

———o———

CONCLUSION

Under Michigan law, no interest can be collected by the lender or his assigns on a note usurious on its face. All payments on such a note are applied against principal. The note in question never had a value in excess of $12,000, which was the amount of the original loan.

The Court of Appeals stated "if valid it [the note] is enforceable on its own terms." In this statement, the Court of Appeals was again in error. The holder of the usurious note has the right to recover the face amount of the note, less any amount paid thereon. The fact that the holder is barred from collection of interest does not make the note invalid.

The lower courts viewed the case from the FDIC standpoint only and concluded that formulation of a new rule of law by the federal judiciary was necessary to

prevent chaos in the national banking system. Neither lower court seemed to appreciate the fact that, by definition, there can be no holder in due course of a note usurious on its face.

In order to permit the FDIC to collect interest on this note, the lower courts had to give the FDIC a status far higher than the status of a holder in due course. The courts had to formulate a federal definition of holder in due course covering this one federal agency in its actions in one type of authorized transaction, i.e., a purchase and assumption transaction. even though the Congress which created the agency did not see fit to do so. Neither the FDIC nor the lower courts suggest any reason why the FDIC did not and does not petition Congress to create the new federal law announced in this case by the Sixth Circuit.

The lower courts are oblivious to the fact that by their actions they have created in the FDIC a property right not enjoyed by any other person or entity in these United States. Nobody, under Michigan law, and either before or after the execution of the note in question, could legally collect any interest, attorney fees, costs, etc., as the holder of the note in question.

The FDIC was not party to either the original note or guaranty; it did not insure or guaranty the performance of either the maker or the lender; it had no connection whatever with the note and guaranty until long after the note was overdue and in litigation. Except for the failure of Community Bank, the note had a value under Michigan law on the date the original judgment was entered of $5,751.76.

The idea that this one federal agency, by its voluntary acquisition of this particular asset of the failed bank, can

thereby almost treble the value of the asset is foreign to any provision contained in either the federal or state laws. The single objective of all usury laws, both state and federal, is to punish the usurious lender. To accomplish this objective, it is necessary to prevent enforcement of the usurious portions of the note agreement in the hands of any assignee, except those who take without notice of the usury.

This is exactly the effect of 12 USC § 1823(e) which, because the FDIC can *never* become a holder in due course in this situation, still protects the agency against those defenses which are not ascertainable by reviewing the failed bank's records.

There is no small irony in the fact that the FDIC prevailed before this Court in *D'Oench,* supra, and in the enactment of 12 USC § 1823(e) on the ground that *it* should not be adversely affected by defenses *of which it had no notice.* The FDIC now uses these authorities to support its current argument that it should not be adversely affected by defenses *of which it had notice,* and, probably, actual knowledge.

It is a perversion of these Federal and State UCC applications of the equitable doctrine of estoppel to bar the obligors from asserting defenses appearing in the instruments and in the bank's records, where only the lender is guilty of misconduct and where the FDIC knew, or should have known, of such misconduct.

Respectfully submitted,

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APPENDIX

No. 84-1124

UNITED STATES COURT OF APPEALS
For The Sixth Circuit

Federal Deposit Insurance Corporation,
in its corporate capacity,

Plaintiff-Appellee,

v.

Richard M. Wood,

Defendant-Appellant.

On Appeal from the United States District Court
for the Eastern District of Michigan.

Decided and Filed March 26, 1985

Before: LIVELY, Chief Judge; MARTIN and JONES, Circuit Judges.

BOYCE F. MARTIN, JR., Circuit Judge. This is an action by the Federal Deposit Insurance Corporation in its corporate capacity to recover on a note that it purchased as part of a purchase and assumption agreement. The issue is whether the FDIC can recover the full amount of interest payable on the note when the jury found it

to be usurious under state law. The district court, in a judgment notwithstanding the verdict, allowed the collection of interest on the ground that the FDIC enjoys a status equivalent to that of a holder in due course. We affirm.

The promissory note in question was signed by Peter R. Stone and Carole K. Barnett, defendants below, and guaranteed by Richard M. Wood, the defendant-appellant. The note was for the principal amount of $12,000, with interest at 15% per annum computed on a 360-day-per-annum basis, an annual percentage rate of 15.21%. It was due on September 22, 1980.

On May 15, 1982, the Community Bank of Washtenaw, which held the note, was declared insolvent and the FDIC was appointed receiver. The FDIC in its capacity as receiver transferred certain liabilities and sold certain assets of the Community Bank to Michigan National Bank of Ann Arbor in a purchase and assumption transaction. The FDIC transferred the remaining, lower-quality assets, including this note, to itself in its corporate capacity. Purchase and assumption transactions have been described in more detail elsewhere. *See Gunter v. Hutcheson,* 674 F.2d 862, 865-66 (11th Cir.), *cert. denied,* 459 U.S. 826 (1982); *FDIC v. Ashley,* 585 F.2d 157 (6th Cir. 1978).

The FDIC action to collect the note was tried before a jury, which delivered a special verdict on October 20, 1983. The jury held, inter alia, that the defendants, including Wood, were liable to FDIC on the note, but that the underlying loan was not made for business purposes. The loan was therefore usurious under Michigan law, and no interest could be allowed. Judgment for the out-

standing principal, $5,751.76, plus postjudgment interest at the statutory rate, was rendered for the FDIC. The appellant does not contest his liability for this amount on appeal.

The FDIC then moved for judgment notwithstanding the verdict for prejudgment interest, and the defendants moved for punitive costs and attorney's fees. The district court held that the FDIC enjoys a status equivalent to that of a holder in due course under state law and is immune to the defense of usury. It therefore denied the defendants' motions and granted the FDIC's motion, allowing the FDIC full contractual interest and costs.

Under Michigan law, parties in general may not agree to any rate of interest exceeding 7% Mich. Comp. Laws Ann. § 438.31 (1978). A usurious lender or his assign is barred from the collection of any interest, official fees, collection charge, attorney fees, or court costs, and the borrower can recover attorney fees and court costs. *Id.* § 438.32. However, banks may loan money at any rate of interest to "business entities"; a natural person is a business entity if he furnishes a sworn statement specifying the type of business and his business purpose. *Id.* § 438.61 (Supp. 1984-1985). Holders in due course are immune to the usury defense under section 438.5 which reads:

> 438.5 *Holder in due course, recovery*
>
> In any action brought on any bill of exchange or promissory note payable in money, and to order or bearer, originally given or made for or upon any usurious consideration or contract, if it shall appear that the plaintiff became, in good faith the indorsee or holder of such bill or exchange or promissory note,

> for a valuable consideration, before the same became due, then and in such case, unless it shall further appear that the plaintiff, at the time of becoming such indorsee or holder, had actual notice that such bill or note was given for or upon a usurious consideration or contract, he shall be entitled to recover thereon, in the same manner, and to the same extent as if such usury had not been alleged and proved.

Id. § 438.5 (1978).

Although the words "holder in due course" appear only in the title, section 438.5 apparently represents an importation of the holder in due course doctrine from the Uniform Commercial Code. A holder in due course is a holder who takes an instrument for value, in good faith, and without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person; provided, inter alia, that the holder did not purchase the instrument as part of a bulk transaction not in the regular course of business of the transferor. Mich. Comp. Laws Ann. § 440.3302 (1967); U.C.C. § 3-302 (1972). A holder in due course takes an instrument free from all defenses of any party to the instrument with whom the holder has not dealt, except those defenses enumerated in Mich. Comp. Laws Ann. § 440.3305 (1967); U.C.C. § 3-305 (1972).

Under state law, the FDIC cannot be a holder in due course, if it had notice that the note was overdue. (The FDIC also is not a holder in due course under state law if the purchase and assumption transaction was out of its ordinary course of business as a receiver, but it appears that this rule in any case is not relevant to the usury defense under section 438.5.) We assume without holding that the FDIC in fact is not a holder in due course under

state law. This case, however, is not under state law, but is under federal law pursuant to 12 U.S.C. § 1819, which reads in relevant part:

> § 1819. *Incorporation; powers; seal*
>
> Upon June 16, 1933, the Corporation shall become a body corporate and as such shall have power—
>
> . . . .
>
> Fourth. To sue and to be sued, complain and defend, in any court of law or equity, State or Federal. All suits of a civil nature at common law or in equity to which the Corporation shall be party shall be deemed to arise under the laws of the United States, and the United States district courts shall have original jurisdiction thereof, without regard to the amount in controversy; and the Corporation may, without bond or security, remove any such action, suit, or proceeding from a State court to the United States district court for the district or division embracing the place where the same is pending by following any procedure for removal now or hereafter in effect, except that any such suit to which the Corporation is a party in its capacity as receiver of a State bank and which involves only the rights or obligations of depositors, creditors, stockholders, and such State bank under State law shall not be deemed to arise under the laws of the United States.

When the FDIC purchases notes in a purchase and assumption transaction, it acts in its corporate capacity. *FDIC v. Ashley,* 585 F.2d 157, 160 (6th Cir. 1978). It follows that federal law applies. *D'Oench, Duhme & Co. v. FDIC,* 315 U.S. 447, 456 (1942). *Cf. United States v. Kimbell Foods,* 440 U.S. 715, 726 (1979) (holding that federal law governs questions involving the rights of the United States arising under nationwide federal programs).

The Supreme Court held in *D'Oench, Duhme* that a secret agreement designed to deceive creditors or the

public authority or tending to have that effect would not be a defense against the FDIC on its collection of a note. This holding is generally considered to have been codified in 12 U.S.C. § 1823(e), which reads:

> (e) *Agreements against interests of Corporation*
>
> No agreement which tends to diminish or defeat the right, title or interest of the Corporation in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.

There is authority that Congress intended by means of section 1823(e) to clothe the FDIC with the protections afforded a holder in due course. *FDIC v. Rosenthal,* 477 F. Supp. 1223, 1226 (E.D. Wis. 1979), *aff'd mem.,* 631 F.2d 733 (7th Cir. 1980); *FDIC v. Rockelman,* 460 F. Supp. 999, 1003 (E.D. Wis. 1978). We believe, however, that although section 1823 manifests the congressional intent to protect the FDIC, it does not of itself authorize holder-in-due-course status. *Gunter v. Hutcheson,* 674 F.2d 862, 867 (11th Cir.), *cert. denied,* 459 U.S. 826 (1982); *see FDIC v. Hatmaker,* — F.2d —, —, No. 83-5866 (6th Cir. 1985) (holding section 1823(e) inapplicable to some frauds in the inducement). If the FDIC has that status, it must be as part of the federal common law.

As federal common law is applicable, but Congress has given no statutory guidance, we are faced with the same problem of giving content to federal law that the Supreme Court faced in *United States v. Kimball Foods,* 440 U.S. 715 (1979). The Court held that, where a national rule is unnecessary to effectuate federal interests, state law should be incorporated as the federal rule of decision. The determinative factors are whether there is need for a nationally uniform body of law, whether application of state law would frustrate specific objectives of the federal program, and whether application of a federal rule would disrupt commercial relationships predicated on state law. *Id* at 728-29. The Court concluded that it was not necessary to adopt a federal rule protecting the priority of liens created by Small Business Administration and Farmers Home Administration loans.

We believe that, if state law mandates that the corporate FDIC cannot be a holder in due course, then application of state law would frustrate important objectives of the federal program. To understand why, we must examine the underlying policies of the law of commercial paper.

A negotiable instrument, such as a note, is a writing signed by the maker, containing an unconditional promise to pay a sum certain in money, on demand or at a definite time, to order or to bearer. Mich. Comp. Laws Ann. § 440.3104 (1967); U.C.C. § 3-104 (1972). If valid, it is enforceable on its own terms. The "real" defenses, such as incapacity, fraud in the factum, and forgery, Mich Comp Laws Ann. §§ 440.3305(2), 440.3401(1) (1967); U.C.C. §§ 3-305(2), 3-401(1) (1972), render the note invalid and unenforceable by anyone.

"Personal" defenses, such as failure of consideration and usury, are not truly defenses against the note itself, but rather are defenses or claims stemming from the underlying transaction. For simplicity, these are allowed as defenses to the note when the original wrongdoer tries to collect on it. But when the note comes into the hands of an innocent party, a holder in due course, he takes it free of all personal defenses. Mich. Comp. Laws Ann. § 440.3305 (1967); U.C.C. § 3-305 (1972). To be innocent, however, a party must be acting in good faith. Mich. Comp. Laws Ann. § 440.1203 (1967); U.C.C. § 1-203 (1972). The holder in due course doctrine is a bright-line elaboration on the good faith requirement.

When an insured bank goes into receivership, the FDIC in most cases will in fact be a good-faith holder of its notes. If the FDIC had no knowledge, prior to receivership, of defenses to the notes, and if it otherwise acted in good faith, it cannot be said that the FDIC is not innocent. If it is true that the state's bright-line requirements prevent the FDIC from being a holder in due course, then it is inappropriate to apply those requirements to a government agency crucial to the existence of the modern banking system when they are without purpose.

If we considered the FDIC to be a holder other than in due course and applied state law, makers of notes would get an unjustified windfall. If the maker has a personal claim against the defunct bank, he would effectively have an absolute priority on that claim. We think a maker with a claim against the defunct bank should have to stand in line with the other unsecured creditors proceeding against the FDIC in its capacity as receiver. To rule otherwise would be to authorize special relief provisions

out of the FDIC's general fund for the benefit of makers, and we believe such relief should be authorized only by Congress. Because collections by the FDIC in its corporate capacity are refunded to the FDIC as receiver, for the benefit of creditors, when collections exceed the amount the corporate FDIC paid in the purchase and assumption transaction, *FDIC v. Ashley,* 585 F.2d 157, 159, 162-63 (6th Cir. 1978), the proposed relief may be not only at the expense of depositors in general, but specifically to the detriment of other creditors of the defunct bank.

The case for giving the FDIC a protected status is made even more compelling by the nature and advantages of purchase and assumption transactions. The FDIC's purpose is "bringing to depositors sound, effective, and uninterrupted operation of the banking system with resulting safety and liquidity of bank deposits." S. Rep. No. 1269, 81st Cong., 2d Sess., *reprinted in* 1950 U.S. Code Cong. & Ad. News 3765, 3765-66; *accord Gunter v. Hutcheson,* 674 F.2d 862, 870 (11th Cir.) (describing FDIC's policies as promoting the stability of and confidence in the nation's banking system), *cert. denied,* 459 U.S. 826 (1982). When an insured bank fails, the use of a purchase and assumption transaction is a dramatically effective way for the FDIC to fulfill its purpose.

The most striking advantage of a purchase and assumption transaction over the alternative, liquidating the bank's assets and paying the depositors their insurance, is its speed. The transaction usually is arranged overnight, so that banking services are not interrupted for a single business day. In contrast, a liquidation may take months—hardly an example of "uninterrupted opera-

tion of the banking system" and "liquidity of bank deposits."

Almost as important are the financial advantages. Depositors receive the full amounts of their deposits, rather than only the insured amounts. *Gunter v. Hutcheson,* 674 F.2d at 870 n.10; *FDIC v. Ashley,* 585 F.2d 157, 163 (6th Cir. 1978). Nevertheless, purchase and assumption transactions are generally less costly to the FDIC than liquidations. In fact, Congress requires that purchase and assumption transactions be made only upon a determination that the cost would be less than that of liquidation, except in the extraordinary case when continued operation of the insured bank is essential to provide adequate banking services in its community. 12 U.S.C. § 1823(c)(4)(A). *See also FDIC v. Merchants National Bank,* 725 F.2d 634, 637-38 (11th Cir.), *cert denied,* 105 S. Ct. 114 (1984).

But the essence of a purchase and assumption transaction is speed. If the FDIC is forced to examine the bank's files to determine the value of its notes in light of the defenses to them, the transaction will not take place. If the FDIC takes a liberal view of its statutory duty and quickly estimates the notes' value based on past experience, there may be many unknown claims to which it will nevertheless be vulnerable. Because some failing banks will have been reasonably scrupulous in obtaining their notes, while others will have many notes with personal defenses, past experience would in many cases be a poor guide to the notes' value. This uncertainty would be aggravated by state variations in the allowance of defenses. *Accord FDIC v. Gulf Life Insurance Co.,* 737 F.2d

1513, 1517 (11th Cir. 1984); *Gunter v. Hutcheson,* 674 F.2d at 870; *Gilman v. FDIC,* 660 F.2d 688, 695 (6th Cir. 1981).

In addition, the congressional mandate that purchase and assumption transactions be less expensive than liquidations, except in extraordinary cases, means that the presence of state-law defenses would in many cases prevent the transaction. The amount the FDIC could not collect from makers with personal defenses would make the transaction that much more expensive. In other words, we are asked not merely to give makers preferential treatment over other creditors and depositors, but we are asked to do so at potentially enormous cost to the banking system as a whole. We think these adverse consequences to allowing makers to assert personal defenses against the corporate FDIC make such a rule unacceptable.

The only remaining consideration is whether treating the FDIC as a holder in due course would disrupt commercial relationships predicated on state law. A negotiable instrument is subject to transfer at any time, and the maker must always be aware that the transferee may be a holder in due course. From the maker's view, there is no difference between his bank failing and the note going to the corporate FDIC, and his bank failing and selling the note to a holder in due course. *See Gunter v. Hutcheson,* 674 F.2d at 872.

For these reasons, we hold that when the FDIC in its corporate capacity, as part of a purchase and assumption transaction, acquires a note in good faith, for value, and without actual knowledge of any defense against the note, it takes the note free of all defenses that would not pre-

vail against a holder in due course. This rule was implicit in this Circuit's holding in *Gilman v. FDIC,* 660 F.2d 688, 695 (6th Cir. 1981), and in the Eleventh Circuit holding in *Gunter v. Hutcheson,* 674 F.2d at 873; it was held in dictum in *FDIC v. Hatmaker,* — F.2d —, — n.5, No. 83-5866 (6th Cir. 1985). We express no opinion whether we would give the FDIC preferential treatment in other contracts. *Cf. FDIC v. Gulf Life Insurance Co.,* 737 F.2d 1513 (11th Cir. 1984) (allowing FDIC to collect unearned premium refunds from life insurance company, notwithstanding defenses of waiver, estoppel, and unjust enrichment).

The defendant argues, however, that the FDIC must be charged with knowledge that the note was usurious. Under the statute, a loan made by a bank to an individual at an interest rate of more than 7% is usurious unless there is a sworn statement specifying the type of business and the business purpose. Mich. Comp. Laws Ann. § 438.61 (Supp. 1984-1985). He argues that the interest rate of 15.21% and the lack of a statement in the bank's files should have warned the FDIC of the usury defense.

That argument ignores our explicit holding in *Gilman* that the FDIC is under no duty, in either of its capacities, to examine the assets of a failed bank before it agrees to execute a purchase and assumption transaction. 660 F.2d at 694. The FDIC cannot, therefore, be charged with knowledge of a defense merely because that information could be found in the bank's files. Furthermore, actual knowledge must be shown as of the date the FDIC entered into the purchase and assumption agreement. *Id.* at 695. *Cf. FDIC v. Merchants National Bank,* 725 F.2d

634, 640 (11th Cir.) (similar holding under 12 U.S.C. § 1823 (e), *cert. denied,* 105 S. Ct. 114 (1984).

In this case, plaintiff's assertion that the FDIC had knowledge of the defense was based only on the fact that an examination of the bank records should have put the FDIC on notice. That allegation is not sufficient to overcome the presumption that the FDIC had no knowledge of any defenses against it.

The case is affirmed.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Civil Action No. 82-60415

FEDERAL DEPOSIT INSURANCE CORPORATION,

Plaintiff,

vs.

PETER R. STONE, CAROLE K. BARNETT, and RICHARD M. WOOD,

Defendants.

HONORABLE CHARLES W. JOINER

MEMORANDUM OPINION AND ORDER

This is an action by the F.D.I.C. to recover on a note that it purchased in connection with the failure of the Community Bank of Washtenaw. The complaint was originally filed by the Community Bank of Washtenaw. The F.D.I.C. in its corporate capacity was substituted as the plaintiff on November 6, 1982.

The F.D.I.C., as receiver, transferred certain liabilities and sold certain assets of the Community Bank of Washtenaw to Michigan National Bank of Ann Arbor in order that the bank could continue, and for the protection of depositors. The F.D.I.C. purchased all of the unacceptable assets of the Community Bank of Washtenaw in connection with the assumption agreement. The loan in question was purchased in this transaction.

The note was signed by the defendants Stone and Barnett and guaranteed by defendant Wood and carried an annual interest rate of 15.21%. All defendants asserted, among other unrelated claims, the defense of usury. During the trial, the F.D.I.C. made a motion for summary judgment on the usury claim. The Court denied the motion at that time and submitted the relevant factual question to the jury, with the understanding that the issue of whether this defense is available against the F.D.I.C. might be raised and fully briefed, if necessary, by way of motion for judgment notwithstanding the verdict.

The jury found that all defendants were liable on the note. The jury further found that the note was not made for a business purpose, which would make it usurious under Michigan law, Mich.Comp.Laws Ann. §§438.31 and 438.61.

This matter is now before the Court on the plaintiff F.D.I.C.'s Motion for Judgment Notwithstanding the Verdict and on the Motions for Costs and Attorney Fees filed by all defendants. For the reasons given below, the plaintiff's motion is granted and the defendants' motions are denied.

The question before the Court is whether the defense of usury may be asserted against the F.D.I.C. with respect to a note purchased in its corporate capacity in connection with an assumption agreement. If this defense is available against the F.D.I.C., the defendants seek costs and attorney fees as sanctions for the usurious loan under Mich.Comp.Laws Ann. §438.32.

By statute, the F.D.I.C. is afforded a position superior to that of the bank from which it purchased the assets and certain defenses that might have been raised against the bank in connection with the note may not be raised against the F.D.I.C. operating in its corporation capacity.

> (e) No agreement which tends to diminish or defeat the right, title or interest of the Corporation in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.

12 U.S.C. § 1823(e). While the statute does not specifically address the problem presently before the Court, it does evidence the intent of Congress to protect the F.D.I.C. when it is acting in its coprorate (sic) capacity and acquiring assets of a bank under section 1823.

In 1942, the Supreme Court in *D'Oench, Duhme & Co. v. F.D.I.C.*, 315 U.S. 447, held that the defense of lack of consideration could not be asserted against the F.D.I.C. by the maker of a note because the maker had participated in creating a questionable asset on the books of the bank. The Court held that it was irrelevant that the maker "was not a participant in this particular transaction and, so far as appears, was ignorant of it," *Id* at 459, because the maker was responsible for the creation

of the false status of the note in the hands of the bank. The Court relied upon the policy of the act to protect the F.D.I.C. from misrepresentations as to the genuineness or integrity of assets appearing on the books of the bank which may have influenced the actions of the F.D.I.C. in its dealings with the bank.

Other courts have read *D'Oench* and the statutory provision cited above as creating a status for the F.D.I.C., acting in its corporate capacity, equivalent to that of a holder in due course. *E.g., F.D.I.C. v. Lesselyoung,* 476 F.Supp. 938 (E.D. Wisc. 1979), *aff'd.* 626 F.2d 1327 (7th Cir. 1980); *F.D.I.C. v. Rockelman,* 460 F.Supp. 999 (E.D. Wisc. 1978). Some cases use the language associated with a holder in due course, *i.e.,* purchased for value, in good faith, and without knowledge of the fraud. *See, e.g., Gunter v. Hutcheson,* 674 F.2d 862, (11th Cir. 1982). In *F.D.I.C. v. Leach,* 525 F.Supp. 1379 (E.D. Mich. 1981), decided in this district, Judge Taylor held that the F.D.I.C. occupied a position of greater strength than that of a holder in due course.

The F.D.I.C., acting in its corporate capacity to rehabilitate a failing bank under the provisions of 12 U.S.C. §1823, must act quickly and must purchase all of the unacceptable assets of the bank. Under the circumstances, it cannot be expected to carefully examine the unacceptable assets before making the necessary decisions to facilitate the transaction. *Gilman v. F.D.I.C.,* 660 F.2d 688 (6th Cir. 1981). Consequently, it is reasonable to characterize the F.D.I.C. as one who takes for value, in good faith, and without notice of any deficiencies in the particular asset.

While the F.D.I.C. does not meet all of the statutory requirements for a holder in due course under the Uniform

Commercial Code §3-302, Mich.Comp.Laws Ann. §440.3302, this Court agrees, with the other courts which have examined this question, that the F.D.I.C. should occupy a status equivalent to that of a holder in due course and have all of the rights that are available to a holder in due course when acting in its corporate capacity. Federal, rather than state, law applies when the action involves the F.D.I.C. and, therefore, the Court is not bound to a technical reading of state statutes on this issue. *D'Oench, supra; Leach, supra* at 1389. This holding is consistent with the Congressional purpose in protecting the F.D.I.C. when it acts pursuant to section 1823 to restore the insured bank to normal operation.

In Michigan, a statutory holder in due course of a promissory note is not subject to the usury defense, unless the holder had actual notice that the note was given at a usurious rate. Mich.Comp.Laws Ann. §438.5. The statute requires actual knowledge and there is no evidence that the F.D.I.C. had such knowledge. Furthermore, in light of the Court of Appeals decision in *Gilman, supra,* the F.D.I.C. is not required to examine the assets it purchases pursuant to section 1823 and, therefore, could not be held liable on a theory of imputed knowledge.

The F.D.I.C. is not subject to the usury defense in this case. It enjoys a status equivalent to a holder in due course and Michigan exempts holders in due course from the operation of the usury statute.

Therefore, the plaintiff's Motion for Judgment Notwithstanding the Verdict is granted. The defendants' Motions for Costs and Attorney Fees were based upon the state usury statute. In view of the holding that the usury

defense is not available against the F.D.I.C., the defendants' motions are denied.

SO ORDERED.

/s/ Charles W. Joiner
United States District Judge

Dated: December 22, 1983
Ann Arbor, Michigan

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION
ANN ARBOR

Case No.: 82-60415

FEDERAL DEPOSIT INSURANCE CORPORATION,
in its corporate capacity,

Paintiff,

vs.

PETER R. STONE, CAROLE K. BARNETT,
and RICHARD M. WOOD,

Defendants.

HON. CHARLES W. JOINER

JUDGMENT
NOTWITHSTANDING THE VERDICT

At a session of said Court held in the United States Courthouse, Ann Arbor, Michigan, on Jan. 23, 1984.

(Filed January 23, 1984)

PRESENT: THE HONORABLE CHARLES W. JOINER
United States District Judge

Plaintiff's Motion for Judgment Notwithstanding the Verdict having come on to be heard and Defendants having filed Answers to the same and the Court having issued its Opinion dated December 22, 1983, and the Court being fully advised in the premises:

IT IS HEREBY ORDERED that Judgment Notwithstanding the Verdict is entered in favor of Plaintiff, FEDERAL DEPOSIT INSURANCE CORPORATION, in its corporate capacity, and against Defendants, PETER

R. STONE, CAROLE K. BARNETT, and RICHARD M. WOOD, jointly and severally, in the amount of $11,400.00 plus interest as of October 19, 1983 in the amount of $3,490.25 at the rate of 15% per annum, plus $4.75 *per diem* thereafter through date of Judgment, plus costs in the amount of $60.00.

A true copy.

Clerk, U.S. District Court
Eastern District of Michigan
/s/ J. Birdsall
Deputy Clerk

/s/ Charles W. Joiner
United States District Judge

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

File No. 82-60415

FEDERAL DEPOSIT INSURANCE CORPORATION,
in its corporate capacity,
Plaintiff,

vs.

PETER R. STONE, CAROLE K. BARNETT and
RICHARD M. WOOD,
Defendants,

• • •

PETER R. STONE and CAROLE K. BARNETT,
Defendants/Cross-Plaintiffs,

vs.

RICHARD M. WOOD,
Defendant/Cross-Defendant,

• • •

RICHARD M. WOOD,
Defendant/Cross-Plaintiff,

vs.

PETER R. STONE and CAROLE K. BARNETT,
Defendants/Cross-Defendants,

• • •

CAROLE K. BARNETT,

Defendant/Cross-Plaintiff,

vs.

PETER R. STONE,

Defendant/Cross-Defendant.

HON. CHARLES W. JOINER

JUDGMENT

At a session of said Court held in the City of Ann Arbor, State of Michigan, on ————————, 1983.

PRESENT: HONORABLE CHARLES W. JOINER
U.S. District Court Judge

This matter having been tried before a jury on October 19 and October 20, 1983; this matter having been submitted to the jury for a special verdict; and the jury having returned a special verdict as follows:

QUESTION 1: Do you find that defendants Peter Stone and Carole Barnett (Stone) signed a promissory note to the Community Bank of Washtenaw?

ANSWER: Yes.

QUESTION 2: Do you find that the loan made to the Stones was made for business purposes?

ANSWER: No.

QUESTION 3: Do you find that the closing of the bank loan to the Stones including a written guaranty by Wood that was conditioned on the fact that Wood reserved the right to obtain the collateral in the event that he paid on the guaranty?

ANSWER: No.

QUESTION 4: Do you find that Defendant Wood is liable to the F.D.I.C.?

ANSWER: Yes.

QUESTION 5: Do you find that there was an agreement between defendant Stone and defendant Wood that if Thought Publications, Inc., never made a profit the loan would be repaid by Wood and that the Stones would not be liable?

ANSWER: Yes.

QUESTION 6: If you found an agreement between Wood and Stone as described in Question 5, did Wood breach any of the terms of that agreement which you found?

ANSWER: Yes.

QUESTION 7: Do you find that Wood committed fraud at the time he negotiated and arranged the loan in one or more of the ways claimed by defendants Stone and Barnett, all as explained in these instructions?

ANSWER: No.

QUESTION 8: If you found in favor of the F.D.I.C. and against either 1) Stone and Barnett, or 2) Wood, or both, do you find that one should reimburse the other for the amount of the liability?

ANSWER: Yes.

QUESTION 9: If the answer is YES to Question 8, indicate who should reimburse whom:

ANSWER: Wood should reimburse Stone and Barnett.

NOW, THEREFORE, judgments are entered in this matter as follows:

1) A judgment in the amount of $5,751.76 is entered in the F.D.I.C.'s favor against all three defendants, joint-

ly and severally. The F.D.I.C. is not entitled to collect any costs, attorney's fees, or pre-judgment interest. Interest shall accrue on the amount of the judgment at the statutory rate beginning on the date of entry of the judgment;

2) A judgment of indemnification is entered in favor of both Stone and Barnett against Wood, for an amount up to the maximum amount which the F.D.I.C. could collect from Stone and/or Barnett pursuant to its judgment against them;

3) A judgment of no cause of action is entered on Wood's cross-claim against Stone and Barnett;

4) A judgment of indemnification is entered in favor of Barnett against Stone, for an amount up to the maximum amount which the F.D.I.C. could collect from Barnett pursuant to its judgment against her.

/s/ Charles W. Joiner

HON. CHARLES W. JOINER

A true copy

Clerk, U.S. District Court
Eastern District of Michigan
/s/ J. Birdsall
Deputy Clerk

438.5 *Holder in due course, recovery*

Sec. 5. In any action brought on any bill of exchange or promissory note payable in money, and to order or bearer, originally given or made for or upon any usurious consideration or contract, if it shall appear that the plaintiff became, in good faith the indorsee or holder of such bill of exchange or promissory note, for a valuable consideration, before the same became due, then and in such case, unless it shall further appear that the plaintiff, at the time of becoming such indorsee or holder, had actual notice that such bill or note was given for or upon a usurious consideration or contract, he shall be entitled to recover thereon, in the same manner, and to the same extent as if such usury had not been alleged and proved.

438.31 *Legal rate*

Sec. 1. The interest of money shall be at the rate of $5.00 upon $100.00 for a year, and at the same rate for a greater or less sum, and for a longer or shorter time, except that in all cases it shall be lawful for the parties to stipulate in writing for the payment of any rate of interest, not exceeding 7% per annum. This act shall not apply to the rate of interest on any note, bond or other evidence of indebtedness issued by any corporation, association or person, the issue and rate of interest of which have been expressly authorized by the public service commission or the securities bureau of the department of commerce, or is regulated by any other law of this state, or of the United States, nor shall it apply to any time

price differential which may be charged upon sales of goods or services on credit. This act shall not be construed to repeal section 78 of Act No. 327 of the Public Acts of 1931, as amended, being section 450.78 of the Compiled Laws of 1948. This act shall not render unlawful, the purchase of any note, bond or other evidence of indebtedness theretofore issued by any borrower not then domiciled in this state, which bear any rate of interest which is lawful under the law of the domicile of the borrower at the date of issue thereof, and in such case any such rate of interest may be charged and received by any person, firm, corporation or association in this state.

Amended by P.A. 1970, No. 227, § 1, Imd. Eff. Nov. 25.

438.32 *Violation of act; penalties; attorney fees and court costs*

Sec. 2. Any seller or lender or his assigns who enters into any contract or agreement which does not comply with the provisions of this act or charges interest in excess of that allowed by this act is barred from the recovery of any interest, any official fees, delinquency or collection charge, attorney fees or court costs and the borrower or buyer shall be entitled to recover his attorney fees and court costs from the seller, lender or assigns.

438.61 *Business entities, definition, interest rate agreements*

Sec. 1. Notwithstanding the provisions of Act No. 326 of the Public Acts of 1966, as amended, being sections

438.31 to 438.33 of the Compiled Laws of 1948, but subject to the provisions of any other applicable law of this state or of the United States which regulates the rate of interest, it is lawful in connection with any extension of credit to any business entity by any state or national chartered bank or insurance carrier for the parties to agree in writing to any rate of interest. For the purposes of this act "business entity" means (1) any corporation, trust, estate, partnership, cooperative or association, or (2) any natural person who furnishes to the extender of the credit a sworn statement in writing specifying the type of business and business purpose for which the proceeds of the loan will be used, but the exemption provided by this act does not apply if the extender of credit has notice that the person signing the sworn statement was not engaged in the business indicated.

P.A.1970, No. 52, § 1, Imd. Eff. July 10.

440.1203 *Contracts, duties, obligation of good faith in performance or enforcement*

Sec. 1203. Every contract or duty within this act imposes an obligation of good faith in its performance or enforcement. P.A.1962, No. 174, § 1203, Eff. Jan. 1, 1964.

440.3302 *Holder in due course*

Sec. 3302. (1) A holder in due course is a holder who takes the instrument

(a) for value; and

(b) in good faith; and

(c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

(2) A payee may be a holder in due course.

(3) A holder does not become a holder in due course of an instrument:

(a) by purchase of it at judicial sale or by taking it under legal process; or

(b) by acquiring it in taking over an estate; or

(c) by purchasing it as part of a bulk transaction not in regular course of business of the transferor.

(4) A purchaser of a limited interest can be a holder in due course only to the extent of the interest purchased. P.A. 1962, No. 174 § 3302, Eff. Jan. 1, 1964.

440.3304 *Purchaser; notice of claim or defense*

Sec. 3304. (1) The purchaser has notice of a claim or defense if

(a) the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay; or

(b) the purchaser has notice that the obligation of any party is voidable in whole or in part, or that all parties have been discharged.

(2) The purchaser has notice of a claim against the instrument when he has knowledge that a fiduciary has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or otherwise in breach of duty.

(3) The purchaser has notice that an instrument is overdue if he has reason to know

(a) that any part of the principal amount is overdue or that there is an uncured default in payment of another instrument of the same series; or

(b) that acceleration of the instrument has been made; or

(c) that he is taking a demand instrument after demand has been made or more than a reasonable length of time after its issue. A reasonable time for a check drawn and payable within the states and territories of the United States and the District of Columbia is presumed to be 30 days.

(4) Knowledge of the following facts does not of itself give the purchaser notice of a defense or claim.

(a) that the instrument is antedated or postdated;

(b) that it was issued or negotiated in return for an executory promise or accompanied by a separate agreement, unless the purchaser has notice that a defense or claim has arisen from the terms thereof;

(c) that any party has signed for accommodation;

(d) that an incomplete instrument has been completed, unless the purchaser has notice of any improper completion;

(e) that any person negotiating the instrument is or was a fiduciary;

(f) that there has been default in payment of interest on the instrument or in payment of any other instrument, except one of the same series.

(5) The filing or recording of a document does not of itself constitute notice within the provisions of this article to a person who would otherwise be a holder in due course.

(6) To be effective notice must be received at such time and in such manner as to give a reasonable opportunity to act on it. P.A.1962, No. 174, § 3304, Eff. Jan. 1, 1964.

440.3305 *Holder in due course; defenses available*

Sec. 3305. To the extent that a holder is a holder in due course he takes the instrument free from

(1) all claims to it on the part of any person; and

(2) all defenses of any party to the instrument with whom the holder has not dealt except

(a) infancy, to the extent that it is a defense to a simple contract; and

(b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and

(c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and

(d) discharge in insolvency proceedings; and

(e) any other discharge of which the holder has notice when he takes the instrument. P.A.1962, No. 174, § 3305, Eff. Jan. 1, 1964.

UNITED STATES CODE ANNOTATED

12 USC § 1819(4)

. . . .

Fourth. To sue and to be sued, complain and defend, in any court of law or equity, State or Federal. All suits of a civil nature at common law or in equity to which the Corporation shall be party shall be deemed to arise under the laws of the United States, and the United States district courts shall have original jurisdiction thereof, without regard to the amount in controversy; and the Corporation may, without bond or security, remove any such action, suit, or proceeding from a State court to the United States district court for the district or division embracing the place where the same is pending by following any procedure for removal now or hereafter in effect, except that any such suit to which the Corporation is a party in its capacity as receiver of a State bank and which involves only the rights or obligations of depositors, creditors, stockholders, and such State bank under State law shall not be deemed to arise under the laws of the United States.

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12 USC §1823(e)

"(e) Agreements against interests of Corporation

No agreement which tends to diminish or defeat the right, title or interest of the Corporation in any asset

acquired by it under this section, either as security for a loan or by purchase, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank."

---

28 USC

§ 1254. Courts of appeals; certiorari; appeal; certified questions

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

(2) By appeal by a party relying on a State statute held by a court of appeals to be invalid as repugnant to the Constitution, treaties or laws of the United States, but such appeal shall preclude review by writ of certiorari at the instance of such appellant, and the review on appeal shall be restricted to the Federal questions presented;

(3) By certification at any time by a court of appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certifi-

cation the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy.

UNITED STATES CONSTITUTION

Article III –

Section 1. The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behavior, and shall, at stated Times, receive for their Services a Compensation, which shall not be diminished during their Continuance in Office.

Section 2. [1] The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority;—to all Cases affecting Ambassadors, other public Ministers and Consuls;—to all Cases of admiralty and maritime jurisdiction;—to Controversies to which the United States shall be a Party;—to Controversies between two or more States;—between a State and Citizens of another State;—between Citizens of different States;—between Citizens of the same State claiming Lands under the Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

Supreme Court, U.S.
FILED
OCT 15 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 84-1952

(2)

In the Supreme Court of the United States

OCTOBER TERM, 1985

RICHARD M. WOOD, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE FEDERAL DEPOSIT INSURANCE CORPORATION IN OPPOSITION

CHARLES FRIED
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25 pp

QUESTIONS PRESENTED

1. Whether the district court had subject matter jurisdiction under 12 U.S.C. 1819 (Fourth) over this suit to which the Federal Deposit Insurance Corporation (FDIC) is a party in its corporate capacity.

2. Whether the FDIC, when it purchases assets from the receiver of an insolvent bank pursuant to 12 U.S.C. 1823 in order to facilitate a purchase and assumption transaction with another insured bank, is shielded from a defense of usury arising under state law that would not prevail against a holder in due course.

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In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 84-1952

RICHARD M. WOOD, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE FEDERAL DEPOSIT INSURANCE CORPORATION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-13) is reported at 758 F.2d 156. The opinion of the district court (Pet. App. 14-19) is reported at 578 F. Supp. 144.

JURISDICTION

The judgment of the court of appeals was entered on March 26, 1985, and the petition for a writ of certiorari was filed on June 12, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This case arose out of the efforts of the Federal Deposit Insurance Corporation (FDIC) to collect on a note, guaranteed by petitioner, that the FDIC acquired as the result of the failure of a bank of which petitioner was a director and major shareholder.

1. The FDIC is a federal agency charged with " 'bringing to depositors sound, effective, and uninterrupted operation of the banking system with resulting safety and liquidity of bank deposits' "(Pet. App. 9, quoting H.R. Rep. 2564, 81st Cong., 2d Sess. 3 (1950)). To that end, the FDIC insures bank deposits. One of the FDIC's most critical functions arises in connection with the failure of an FDIC-insured bank. When such a bank is closed by its chartering authority, the FDIC must act quickly to meet its statutorily mandated responsibility of protecting depositors and preserving public confidence. One option is for the FDIC simply to pay the depositors their insured amounts. See 12 U.S.C. 1821(f). In that event, the failed bank's receiver (usually the FDIC itself, acting in a separate capacity) then liquidates the assets of the bank and distributes the proceeds to the bank's creditors, including uninsured depositors.[1] This option, which is sometimes referred to as a "deposit payoff," has several disadvantages, not the least of which is that public confidence in the banking system may be severely undermined because of the disruption of service. These consequences undermine the FDIC's goal of assuring uninterrupted operations and liquidity of deposits. Pet. App. 9-10.[2]

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[1]In most cases, the FDIC is appointed as receiver of the failed bank by the appropriate banking authority. The FDIC is required by statute to accept such an appointment if tendered. 12 U.S.C. 1821(c) and (e). As a result, in almost all cases in which a bank fails, the FDIC acts in two separate capacities: in its corporate capacity as insurer of deposits, and as the receiver of the failed bank. 12 U.S.C. 1823(d) and (e). See Pet. App. 2.

[2]Under the "deposit payoff" alternative, all banking services are abruptly interrupted; time, demand, and savings deposits are frozen; and all checks drawn on the closed bank's accounts are returned unpaid. Bank depositors are left without access to their funds on deposit during the time it takes the FDIC to determine the amount of deposit insurance owed to each depositor and to prepare for payment. Moreover, depositors who have deposits exceeding the $100,000 insurance coverage (12

The FDIC has an alternative method of addressing the problems presented by a bank failure that avoids the disadvantages of a deposit payoff. This method is known as the "purchase and assumption transaction." Pursuant to the authority conferred on it by Congress under 12 U.S.C. 1823(c)(2)(A), the FDIC, in its corporate capacity, may purchase assets of a failed insured bank in order to facilitate the purchase of certain other assets and the assumption of all deposit liabilities of the failed bank by another insured bank (referred to as the "assuming bank"). Generally, the assuming bank reopens the doors of the failed bank on the next business day, thereby preventing any loss or inconvenience to depositors and any interruption of vital banking services. In addition, the failed bank's receiver is able to realize some benefit from a valuable asset of the bank that otherwise would be lost: the premium paid by the assuming bank for the "going concern" value of the bank.

The detailed mechanics of a purchase and assumption transaction have been described by the court below (Pet. App. 2) and other courts. See *Gunter* v. *Hutcheson*, 674 F.2d 862, 865-866 (11th Cir.), cert. denied, 459 U.S. 826 (1982); *In re F & T Contractors, Inc.*, 718 F.2d 171, 174 (6th Cir. 1983). Briefly, a purchase and assumption transaction requires the assuming bank to purchase only those assets of the failed bank that are believed to be of the highest banking quality. As a result, the amount of deposit liabilities that bank assumes is greater than the value of the assets it purchases. The receiver of the failed bank therefore agrees to pay in cash to the assuming bank an amount sufficient to cause the assets it purchases to be equal in amount to the

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U.S.C. 1821(a)) and other creditors must await the payment of dividends from the receiver's liquidation of the bank's assets. The liquidation proceedings often take years, and creditors may never recover the full amount of their claims. See Pet. App. 9-11.

liabilities it assumes, less a credit for the premium paid by the assuming bank for the "going concern" value of the failed bank. Payment of these funds by the receiver is made possible by the FDIC, acting in its separate corporate capacity. The FDIC purchases from the receiver all remaining assets of the failed bank that were not acquired by the assuming bank. As consideration, the FDIC pays cash from its Permanent Insurance Fund (12 U.S.C. 1817) to the receiver in an amount equal to the difference between the value of the failed bank's assets acquired by the assuming bank and the amount of deposit liabilities it assumed, less an amount equal to the premium paid by the assuming bank for the "going concern" value of the failed bank. 12 U.S.C. 1823(c)(2)(A). To minimize the resulting loss to the Permanent Insurance Fund, the FDIC then attempts to collect on the assets it has acquired from the receiver.

It is imperative that the FDIC consummate the purchase and assumption transaction as quickly as possible in order to provide protection for depositors, to lessen the potential adverse impact of a bank failure on the community and the public in general, and to capture the "going concern" value of the bank as an asset. See generally Pet. App. 9-10. However, in authorizing the implementation of these transactions as the preferred method for minimizing the adverse consequences of a bank failure, Congress at the same time sought to assure protection for the FDIC's Permanent Insurance Fund. Accordingly, Congress provided that the FDIC may facilitate a purchase and assumption transaction only if the cost to the Fund would be less than that of a liquidation and deposit payoff. 12 U.S.C. 1823(c)(4)(A). As a practical matter, this determination, sometimes referred to as the "cost test," must be made immediately upon a bank's failure if the FDIC is to consider the purchase and assumption transaction alternative at all. Pet. App. 9-10.

2.a. Petitioner was a major shareholder in the Community Bank of Washtenaw in Ypsilanti, Michigan (Community Bank) and served as one of its directors and as its attorney. Petitioner had agreed to purchase the interest of Peter Stone in a company called Thought Publications, Inc (TPI). The company owed Stone unpaid salary totalling $12,000, but had insufficient funds to pay the debt. As part of the purchase transaction, petitioner arranged for a loan of $12,000 to be made by the Community Bank to Stone and Carole Barnett (formerly Carole Stone). Petitioner guaranteed the loan and assured the Stones that he would be solely responsible for payment of the principal, out of the profits of TPI. Pet. App. 2-3, 15; 10-20-83 Tr. 13, 18-19; 10-23-83 Tr. 23.

On May 15, 1982, Community Bank was declared insolvent, and the FDIC was appointed as its receiver. On the same day, the FDIC, as receiver, solicited bids from other insured banks in an attempt to effect a purchase and assumption transaction. The highest acceptable bid was submitted by Michigan National Bank of Ann Arbor, which agreed to assume the deposit liabilities, to purchase certain assets of Community Bank, and to reopen the Community Bank's offices under the name of the Ann Arbor Bank. In order to facilitate the transaction, the FDIC, in its corporate capacity, purchased from the receiver the Community Bank assets that the Ann Arbor Bank did not acquire. Pet. App. 2, 15.

The note executed by Stone and Barnett was among the assets purchased by the FDIC. Community Bank, represented by petitioner, previously had filed suit in state court against Stone and Barnett to collect the balance of the principal and accrued interest on the note, which was allegedly in default. Pet. App. 14. On November 6, 1982, the FDIC, as holder of the note and of petitioner's guaranty, was substituted in its corporate capacity for Community

Bank as the plaintiff in the suit. Petitioner was then added as a defendant. The FDIC subsequently removed the action to the United States District Court for the Eastern District of Michigan pursuant to 12 U.S.C. 1819 Fourth and 28 U.S.C. 1345. As a defense to the amended complaint, petitioner, Stone and Barnett asserted that the loan was usurious under Michigan law because it bore an interest rate of 15.21%. Michigan law provides in general that a loan made by a bank to an individual at an interest rate of more than 7% is usurious unless the individual furnishes a sworn statement that the loan is for a business purpose. Mich. Comp. Laws. Ann. §§ 438.31, 438.61 (1978). Michigan law further provides that as a penalty, a lender who enters into a note that does not comply with the usury law is barred from recovering *any* interest on the note and is liable to the borrower for attorney fees and court costs. *Id.* § 438.32. However, Michigan law provides that a holder in due course is entitled to collect on the note as if usury had not been alleged and proved. *Id.* § 438.5; See Pet. App. 26-28.

The case was tried to a jury, which found that all defendants were liable on the note, but that the note was not made for a business purpose (Pet. App. 22-25). Petitioner and the other defendants then moved to collect attorney fees and court costs from the FDIC under the Michigan usury law, in addition to the disallowance of interest, and the FDIC moved for judgment notwithstanding the verdict on the usury issue (*id.* at 15). The district court granted the FDIC's motion, permitting the FDIC to collect the interest on the note as well as the principal. The court held that when the FDIC acquires a note in a purchase and assumption transaction, it enjoys a status equivalent to that of a holder in due course if it does not have actual knowledge that the note was given at a usurious rate. Applying that rule to the facts of this case, the court found that the FDIC did not have

actual knowledge that the note was given at a usurious rate, and it concluded that the FDIC therefore was not subject to the usury defense raised by the defendants. The district court accordingly also denied the motion of petitioner and the other defendants to recover attorney fees and costs from the FDIC. Pet. App. 14-19.

b. Although petitioner did not contest his liability for the principal amount, he appealed the district court's rejection of the usury defense and its resulting allowance of interest.[3] The court of appeals affirmed (Pet. App. 1-13). Following the analysis set forth by this Court in *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979), the court of appeals held that when the FDIC, acting in its corporate capacity and in the course of a purchase and assumption transaction, acquires a note in good faith, for value, and without actual knowledge of any defense against the note, federal common law shields the FDIC from a usury defense that would not prevail against a holder in due course (Pet. App. 1-12). The court of appeals also held, as it previously has done in *Gilman* v. *FDIC*, 660 F.2d 688 (6th Cir. 1981), that the FDIC is not under a duty, in either of its capacities, actually to examine the records of a failed bank before it agrees to execute a purchase and assumption transaction, and that it therefore cannot be charged with knowledge of a defense merely because that information could be obtained by searching through a failed bank's files (Pet. App. 12-13).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of another court of appeals. Review by this Court therefore is not warranted.

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[3]Stone and Barnett did not appeal the award of interest.

1. Petitioner first contends (Pet. 9-13) that the federal courts have no "subject matter jurisdiction" in this case. It does not appear, however, that petitioner intends this objection to be taken literally, because petitioner states (Pet. 11) that he does not question the right of the FDIC under 12 U.S.C. 1819 to remove the case to federal district court for determination. Petitioner is clearly correct in this concession.

Section 1819 Fourth provides in relevant part:

> All suits of a civil nature at common law or in equity to which the Corporation shall be a party *shall be deemed to arise under the laws of the United States, and the United States district courts shall have original jurisdiction thereof, without regard to the amount in controversy*; * * * except that any such suit to which the Corporation is a party in its capacity as receiver of a State bank and which involves only the rights or obligations of depositors, creditors, stockholders, and such State bank under State law shall not be deemed to arise under the laws of the United States.

Under this provision, the federal courts lack jurisdiction only when the FDIC is a party to a suit as receiver of a state bank and the suit involves only the rights or obligations of depositors, creditors, stockholders and the bank under state law. *FDIC* v. *Sumner Financial Corp.*, 602 F.2d 670, 677-679 (5th Cir. 1979); *FDIC* v. *Godshall*, 558 F.2d 220 (4th Cir. 1977). But, where the FDIC, in its separate corporate capacity, is asserting its own rights to realize on assets — such as the note and guaranty at issue in this case — Section 1819 expressly confers jurisdiction on the federal district courts to entertain the suit. *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447, 455 (1942); *FDIC* v. *Ashley*, 585 F.2d 157 (6th Cir. 1978); *FDIC* v. *Sumner Financial Corp.*, 602 F.2d 670 (5th Cir. 1979); *FDIC* v. *de Jesus Valez*, 678

F.2d 371 (1st Cir. 1982); *In re F & T Contractors, Inc.*, 718 F.2d 171 (6th Cir. 1983).[4] The district court therefore clearly had subject matter jurisdiction in this case.

2. Petitioner's contention that the federal courts lack subject matter jurisdiction apparently is intended to be but another way of arguing that this case should be governed by state rather than federal law and that petitioner therefore should not be liable for interest on the note because it was usurious under state law. See Pet. 10. It is clear, however, that federal law governs this lawsuit. There can be no doubt that the FDIC derives its authority from a specific Act of Congress in the exercise of a "constitutional function or power," and that the overriding federal interests in the FDIC's exercise of its statutory responsibilities in administering a nationwide federal program warrant the protection of federal law. See *United States* v. *Kimbell Foods*, 440 U.S. 715, 726-727 (1979); *United States* v. *Yazell*, 382 U.S. 341, 354 (1966); *Clearfield Trust Co.* v. *United States*, 318 U.S. 363, 366-367 (1943). Indeed, as the court of appeals recognized (Pet. App. 6), this Court already has specifically held that federal law governs in a suit by the FDIC to recover on a note. See *D'Oench, Duhme*, 315 U.S. at 456.

3. The remaining question, then, is what the content of federal law should be in the circumstances of this case — *i.e.*, whether state law should be adopted as federal law, or whether a separate federal rule should be fashioned. Under Michigan law, a usurious note is not void, and the lender is entitled to recover the principal; however, as a penalty for entering into the agreement, the lender is barred from recovering interest, and attorney fees and costs may be assessed against him. Mich. Comp. Laws. Ann. § 438.32

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[4]Federal jurisdiction is also available under 28 U.S.C. 1345, because the FDIC is an agency of the United States that was expressly authorized by Congress under 12 U.S.C. 1819 to bring this suit.

(1978). See *FDIC* v. *Leach*, No. 82-1003 (6th Cir. Sept. 11, 1985), slip op. 5 n.1; *Osinski* v. *Yowell*, 135 Mich. App. 279, 286-288, 354 N.W. 2d 318, 322 (1984); *Bebee* v. *Grettenberger*, 82 Mich. App. 416, 422-423, 266 N.W. 2d 829, 832 (Ct. App. 1978). However, if the note passes to a person who takes the note in good faith for valuable consideration before it becomes due, and without actual notice that it was given upon a usurious consideration, that person is entitled to recover on the note to the same extent as if no usury defense had been raised. Mich. Comp. Laws Ann. § 438.5 (1978). The latter provision in effect applies the doctrine of holder in due course in the context of usury. The court of appeals assumed without deciding that the FDIC was not a holder in due course as a matter of state law for purposes of avoiding the state-law usury penalty (Pet. App. 4-5).[5] But the court of appeals concluded that the usury penalty should not be applied against the FDIC where it acted in good faith and without actual knowledge that the note was usurious. This conclusion was correct, particularly in the circumstances of this case.

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[5]Petitioner asserts (Pet. 13) that both courts below ruled that the FDIC is not a holder in due course under the Uniform Commercial Code, as embodied in Mich. Comp. Laws Ann. § 440.3302 (1967). It is true that the district court so stated (albeit without specifying what requirement of holder in due course status the FDIC does not satisfy (see Pet. App. 17-18)), but the court of appeals expressly did *not* decide that question (see Pet. App. 4-5).

Separate provisions of Michigan law concerning commercial paper provide that a person does not become a holder in due course of an instrument "by purchasing it as part of a bulk transaction not in the regular course of business of the transferor." Mich. Comp. Laws Ann. § 440.3302(3)(c) (1967); Pet. App. 29. Petitioner contends (Pet. 14-16) that this limitation applies under Michigan's usury laws as well and that the FDIC could not be a holder in due course — and therefore could not overcome petitioner's defense of usury — because the FDIC acquired the note at issue here as part of a bulk transaction following the failure of the Community Bank. However, as the court of appeals observed (Pet. App. 6), it does not appear that the "bulk transaction" limitation applies to the provision for overcoming the usury defense under Mich.

In *Kimbell Foods*, the Court observed that whether to adopt state law in a particular instance or to fashion a separate federal rule is "dependent upon a variety of considerations always relevant to the nature of the specific governmental interests and to the effects upon them of applying state law." 440 U.S. at 728, quoting *United States* v. *Standard Oil Co.*, 332 U.S. 301, 310 (1947). The Court identified three such considerations in *Kimbell Foods*: whether there is a need for a nationally uniform body of law, whether application of state law would frustrate specific objectives of the federal program, and the extent to which application of a federal rule would disrupt commercial relationships predicated on state law. 440 U.S. at 728-729. These factors all counsel against application of the state law usury penalty against the FDIC.

a. First, the very nature of the statutory program for promoting stability and confidence in the Nation's banking system furnishes a compelling reason for a uniform federal rule protecting the FDIC's status as a holder of assets that it acquired in good faith and without actual knowledge of a defect under state law. The Court recognized this reality in *D'Oench, Duhme*. There the Court held that a uniform federal rule, rather than state-law holder-in-due-course principles, should be applied to protect the FDIC from undisclosed side agreements that would otherwise defeat the FDIC's interest in notes it acquired from a failed bank. The Court ruled that such arrangements are inconsistent with the policy of the federal statute under which the FDIC operates. 315 U.S. at 455, 459-462.

Comp Laws. Ann. § 438.5 (1978). That exception is not mentioned in Section 438.5, even though that Section does list other conditions commonly associated with holder in due course status. The omission therefore appears to be deliberate.

The Court's subsequent decisions have adhered to this view of the protections that must be afforded the FDIC. In *Kimbell Foods*, the Court, quoting its prior decision in *United States* v. *Yazell*, 382 U.S. 341, 354 (1966), observed that "federal programs that 'by their nature are and must be uniform in character throughout the Nation' necessitate formulation of controlling federal rules." 440 U.S. at 728. In *Yazell*, one of the examples the Court cited for the proposition quoted in *Kimbell Foods* was the uniform federal rule fashioned for the protection of the FDIC in *D'Oench, Duhme*. The *Yazell* Court observed that "[t]he bank deposit insurance program is general and standardized," and "[i]n all relevant aspects, the terms are explicitly dictated by federal law." 382 U.S. at 354, citing the Federal Deposit Insurance Act, 12 U.S.C. 1811 *et seq*. Similarly, in *Illinois* v. *Milwaukee*, 406 U.S. 91 (1972), upon which the Court also relied in *Kimbell Foods* (see 440 U.S. at 728), the Court again cited *D'Oench, Duhme* as an example of a situation in which the Court had fashioned federal common law because "there [was] an overriding federal interest in the need for a uniform rule of decision or where the controversy touches basic interests of federalism" (406 U.S. at 105 n.6).[6] The court of appeals properly adhered to this view here. See also *Gunter* v. *Hutcheson*, 674 F.2d at 869-870.

b. Second, aside from the overriding need for uniformity under the FDIC insurance program as a general matter, application to the FDIC of penalties under the state law of usury, even where the FDIC acquires assets in good faith and without actual knowledge, "would frustrate specific

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[6]The Court's subsequent decision in *Milwaukee* v. *Illinios*, 451 U.S. 304 (1981), did not question either the correctness of its decision in *Illinois* v. *Milwaukee* under then-exsisting laws or, in particular, the Court's approval in the latter decision of *D'Oench, Duhme* as an appropriate occasion for the fashioning of a federal common law rule. See 451 U.S. at 314; *id.* at 336 (Blackmun, J., dissenting).

objectives of the federal program[]" (*Kimbell Foods*, 440 U.S. at 728). As we have explained above, one of the most effective ways in which the FDIC can fulfill its statutory responsibilities is to arrange a purchase and assumption transaction, in lieu of the less favorable alternative of paying insured deposits and liquidating the failed bank's assets. However, the FDIC is authorized to enter into a purchase and assumption transaction only when it determines the transaction will cost less than the cost of a "deposit payoff." It would be impossible for the FDIC to estimate with reasonable accuracy its potential loss from a purchase and assumption transaction within the limited time available if the FDIC were to be subject to potential state law claims of usury of which it lacks knowledge. Moreover, a purchase and assumption transaction must be consummated with extraordinary speed if any "going concern" value of the failed bank is to be retained and public confidence maintained; requiring the FDIC to conduct a detailed examination of the bank's files and to consider the value of each of its assets in light of the potential state law defenses and penalties would substantially impair the FDIC's ability to act with the necessary dispatch. The result urged by petitioner therefore would hinder the implementation of purchase and assumption transactions, which afford an essential means of addressing the problems created by a failed bank in a way that minimizes the disruptions of the banking system and protects the resources of the insurance fund that affords protection for depositors generally. See Pet. App. 7-11.

By the same token, the FDIC, unlike an ordinary assignee who acquires an interest through a voluntary, arms-length transaction, is not a "voluntary" creditor in any meaningful sense of the term when it acquires assets pursuant to a purchase and assumption transaction. In *Kimbell Foods*, the term "voluntary creditor" was applied to federal

agencies that were involved in a lending transaction from its inception, were able to tailor the transaction in light of applicable state law, and were thus able to control the factors that made collection of an obligation likely. See 440 U.S. at 732-733, 734-736. When the FDIC is faced with the liquidation of the assets of a failed bank, it does not have any of these opportunities. Moreover, the FDIC-administered insurance program is not a form of "social welfare legislation" primarily designed for the benefit of particular private persons (see *Kimbell Foods*, 440 U.S. at 735); it benefits the banking system and the Nation as a whole by assuring stability of institutions that are essential for the conduct of commerce.

We note as well that the effect of applying state law in full force in these circumstances would be to prohibit the FDIC from recovering any interest, not merely an amount in excess of the ceiling under state law, and to expose the FDIC to payment of attorney fees and costs as well. The result would be to invoke against an agency of the United States what state law itself designates as a "penalty" — a consequence that ordinarily is barred absent express congressional consent. *FDIC* v. *Tito Castro Construction, Inc.*, 548 F. Supp. 1224 (D. P.R. 1982), aff'd on other grounds, 741 F.2d 475 (1st Cir. 1984); *In re Charter Executive Center, Ltd.*, 34 Bankr. 131 (M.D. Fla. 1983). See *Missouri Pac. Ry.* v. *Ault*, 256 U.S. 554 (1921).

c. Third, taking account of possible countervailing considerations, the federal rule applied by the court of appeals does not disrupt commercial relations predicated on state law. It is doubtful that the potentiality of a bank failure plays a role in the ordinary commercial expectations of the parties. *Gunter* v. *Hutcheson*, 674 F.2d at 872. Moreover, under the court of appeals' decision, the FDIC is simply placed in the same position as a holder in due course who, even under Michigan law, is not subject to the defense of

usury and the resulting penalty. As a result, petitioner's position is no worse than he would have been in had the Community Bank transferred the note to another banking institution in the ordinary course of business. The prospect that a note might be transferred to a holder in due course in that manner is far more likely to have been within the commercial expectations of the parties than is the potential that the lending bank might fail at a time when the note remained in its portfolio. For these reasons, the need to avoid interference with the federal statutory policy of promoting stability and confidence in the Nation's banking system far outweighs the remote possibility that commercial expectations founded in the Michigan law of usury might be affected by a federal rule protecting the FDIC against state law usury claims in circumstances such as these. Compare *Kimbell Foods*, 440 U.S. at 739-740.

d. Other federal courts likewise have held that a debtor cannot invoke state usury penalties to reap a windfall forfeiture of a debt that came into the possession of the FDIC through a purchase and assumption transaction. See *FDIC* v. *Tito Castro Construction Co.*, 548 F. Supp. 1224 (D.P.R. 1982), aff'd on other grounds, 741 F.2d 475 (1st Cir. 1984); *In re Charter Executive Center Ltd.*, 34 Bankr. 131, 135 (M.D. Fla. 1983); *FDIC* v. *Rood*, No. 82-1245-CIV-TGC (M.D. Fla. Nov. 18, 1983). See also *FDIC* v. *Leach*, No. 82-1003 (6th Cir. Sept. 11, 1985), slip op. 5-8. Applying similar principles, the FDIC also has been accorded protection against certain other state law defenses. See *Gunter* v. *Hutcheson*, 674 F.2d at 873; *Gilman* v. *FDIC*, 660 F.2d 688, 695 (6th Cir. 1981); *FDIC* v. *Hatmaker*, 756 F.2d 34, 38 (6th Cir. 1985); *FDIC* v. *Leach*, slip op. 8-10. In view of the consistent treatment of these issues by the lower federal courts, there is no occasion for review by this Court.

Moreover, the Court of Appeals of Michigan also has recently held that the FDIC is not subject to the defense of usury under Michigan law in a suit brought by the FDIC in its corporate capacity. *FDIC* v. *Garbutt*, 370 N.W.2d 387, 391-392 (Mich. App. 1985). In so holding, the court relied on *D'Oench, Duhme* and the district court decisions in the instant case and *FDIC* v. *Leach, supra*, and it recognized the "strong policy concerns implicated in a purchase and assumption transaction" and the need "to facilitate the congressional intent to protect the FDIC and the public funds it administers" by according it a status similar to that of a holder in due course. 370 N.W.2d at 392. Thus, the Michigan Court of Appeals and the federal courts are in agreement regarding the proper application of federal law and Michigan law in this precise context.

e. The application of a federal rule to preclude petitioner from invoking the penalty features of Michigan's usury law is particularly appropriate in this case. Petitioner was a director and principal shareholder of Community Bank and was instrumental in arranging the loan by Community Bank as part of a broader transaction for his personal benefit. It would be inequitable indeed if petitioner, at the expense of the Permanent Insurance Fund, now were permitted to avoid liability for the interest on the note he arranged and guaranteed. Cf. 12 U.S.C. 1828(j)(2). Compare *Eiberger* v. *West*, 247 Ga. 767, 281 S.E. 2d 148 (1981); *Miro* v. *Allied Finance Corp.*, 650 S.W.2d 938 (Tex. Civ. App. 1983); *Cohn* v. *Receivables Finance Co.*, 260 N.E.2d 67 (Ill. App. 1970); *Heubusch* v. *Boone*, 213 Va. 414, 192 S.E.2d 783 (1972).

4. Finally, petitioner contends (Pet. 16-18, 21, 25) that the federal rule adopted by the court of appeals should not be applied in the circumstances of this case because the note was unsurious on its face and the FDIC therefore had actual

knowledge of its usurious nature. This fact-bound contention was correctly rejected by the court of appeals (Pet. App. 12-13) and does not warrant review.

The note indicated that interest would accrue at an annual rate of 15.21%. Such a note is not usurious on its face under Michigan law. Whether such a note is or is not usurious depends on whether the lender has secured a sworn statement that indicates that the loan is for a business purpose. An assignee who acquires a note with a 15.21% interest rate who is unaware of the fact that the required statement has not been filed, and who is entitled to holder in due course status under Michigan law, is not subject to a maker's usury defense. Mich. Comp. Laws Ann. § 438.5 (1978). Such a note becomes usurious only upon consideration of factors that are entirely independent of the note itself. The district court below found no evidence that the FDIC had actual knowledge of the fact that the note was usurious because of either the absence of a business purpose or the absence of a sworn statement concerning the business purpose (Pet. App. 18).

Petitioner contends that the FDIC should be deemed to have knowledge of everything in a failed bank's records, including the fact that a sworn statement concerning a business purpose was not contained therein. The courts have not placed such a burden on the FDIC, because to do so would significantly impair its ability to perform the "cost test" with the dispatch necessary to implement a purchase and assumption transaction. See Pet. App. 12-13. As the Sixth Circuit stated in *Gilman* v. *FDIC*, 660 F.2d at 695:

> To hold the FDIC responsible retroactively for the misdeeds of the predecessors of which it is ignorant when it agrees to repurchase all returned assets would hamper the FDIC's ability and inclination to opt for a Purchase and Assumption arrangement. The FDIC would never be able to enter one with a clear assessment of the amount of worthless paper and litigation it

might face. This dilemma would, in turn, frustrate the public policies behind the scheme of national banking insurance.

See also *FDIC* v. *Garbutt*, 370 N.W.2d at 392 (approving *Gilman* analysis).[7]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[7]Contrary to petitioner's assertion (Pet. 24-27), the intra-FDIC transfer of assets when it enters into a purchase and assumption transaction satisfies the "good faith" criterion. See *Gunter* v. *Hutcheson*, 674 F.2d at 873-874. Other federal courts have recognized that the FDIC may deal with itself in its dual capacities as receiver of a failed bank and as corporate insurer of bank deposits. *FDIC* v. *Godshall*, 558 F.2d 220 (4th Cir. 1977); *FDIC* v. *Glickman*, 450 F.2d 416 (9th Cir. 1971).